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Supreme Court of the United States

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS)

Petitioner,

v.

NEW YORK STOCK EXCHANGE, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Is the New York Stock Exchange, a private entity that operates unhindered by constitutional limitations on governmental actors, entitled to claim absolute immunity against a suit by investors on the ground that it stands in the Securities and Exchange Commission's shoes even when it fails to enforce trading rules and regulations and acts instead to facilitate market manipulation and fraud?

PARTIES TO THE PROCEEDING

Petitioner California Public Employees' Retirement System (CalPERS) is a court-appointed Lead Plaintiff in this securities class action under the Securities Exchange Act of 1934 (the "Exchange Act" or "1934 Act"), acting on behalf of itself and all others who purchased securities listed on the New York Stock Exchange ("NYSE"), between October 17, 1998, and October 15, 2003 (the "Class Period").

The NYSE is a for-profit corporation that was nominally a non-profit during the Class Period but that was then preparing to reorganize as a for-profit venture, and that has since issued shares and is now a publicly traded for-profit company. The NYSE qualifies as a Self-Regulatory Organization or "SRO" under the Exchange Act which defines "self-regulatory organization" to include any "national securities exchange, registered securities association, or registered clearing agency," 15 U.S.C. §78c(a)(26), and which requires an SRO itself to comply with the Exchange Act, "the rules and regulations thereunder, and its own rules," and also to "enforce compliance . . . with such provisions by its members and persons associated with its members." 15 U.S.C. §78s(g).

The NYSE was the only defendant-appellee before the Second Circuit, as the underlying case proceeded – and continues to proceed – against its Specialist Firms in the district court. Additional defendants in those proceedings before the district court are the NYSE's Specialists, who were not parties to the Rule 54(b) appeal to the United States Court of Appeals

for the Second Circuit that produced the judgment review of which is hereby sought. They are:

LaBranche & Co., Inc.,

LaBranche & Co., LLC;

George M.L. LaBranche, IV;

Bear Wagner Specialists LLC;

Bear Stearns & Co., Inc.;

Spear, Leeds & Kellogg Specialists LLC;

Spear, Leads & Kellogg, LP;

The Goldman Sachs Group, Inc.;

Goldman Sachs & Co.;

Van der Moolen Specialists USA, LLC;

Van der Moolen Holding N.V.;

FleetBoston Financial Corporation;

Fleet Specialist, Inc.;

Bank of America Corporation;

Quick & Reilly, Inc.;

Performance Specialist Group, LLC;

Kellogg Group, LLC;

Susquehanna Specialists, Inc. (also known as SIG Specialists, Inc.);

Susquehanna International Group, LLP; and

Susquehanna Financial Group, LLP (collectively, the "Specialist Firms").

CORPORATE DISCLOSURE STATEMENT

Petitioner California Public Employees' Retirement System (CalPERS) is the largest public-employee retirement system in the United States, with nearly 1.5 million beneficiaries, and assets substantially exceeding $200 billion. CalPERS is administered by a 13-member Board of Administration, whose members are either elected by members of the retirement system, appointed, or designated by law to be on the Board. CalPERS has no parent corporation, and no publicly held corporation owns an interest in it.

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PETITION FOR A WRIT OF CERTIORARI

CITATIONS TO THE OPINIONS BELOW

The decision of the United States District Court for the Southern District of New York, dismissing with prejudice claims against the NYSE, was published as *In re NYSE Specialists Sec. Litig.*, 405 F. Supp. 2d 281 (S.D.N.Y. 2005), and is reprinted in the appendix hereto at Pet. App. 30a-135a.[1]

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[1] Related decisions issued on the same date, sustaining claims against other defendants who engaged with the NYSE in the same scheme and course of conduct that operated as a fraud on investors, were reported as *In re LaBranche Sec. Litig.*, 405 F.

The Second Circuit's opinion affirming the dismissal in relevant part was published as *In re NYSE Specialists Litig. (California Public Employees' Retirement System v. The New York Stock Exchange)*, 503 F.3d 89 (2d Cir. 2007), and is reprinted in the appendix hereto at Pet. App. 1a-29a.

JURISDICTION

The district court exercised jurisdiction over this federal securities-fraud class action under 28 U.S.C. §1331 and 15 U.S.C. §78aa.

The district court certified its order dismissing claims against the NYSE for entry of a final appealable judgment pursuant to Federal Rule of Civil Procedure 54(b), upon a finding that there was no just reason for delay, thereby giving the United States Court of Appeals appellate jurisdiction under 28 U.S.C. §1291. Pet. App. 136a-139a.

The Second Circuit issued its judgment affirming in part and vacating in part on September 18, 2007. *See* Pet. App. 1a-29a. No petition for rehearing was filed.

On December 7, 2007, Justice Ruth Bader Ginsburg granted CalPERS' application for an extension of time within which to file a petition for a writ of certiorari, and extended the time to January 16, 2008. *See California Public Employees' Retirement System v. New York Stock Exchange, Inc.*, Application No. 07A483 (Dec. 7, 2007).

This Court has jurisdiction under 28 U.S.C. §1254 to review the judgment of the Second Circuit.

Supp. 2d 333 (S.D.N.Y. 2005), and as *In re Van der Moolen Holding N.V. Sec. Litig.*, 405 F. Supp. 2d 388 (S.D.N.Y. 2005).

STATUTORY PROVISIONS INVOLVED

Relevant statutory provisions are set out in the appendix hereto. *See* Pet. App. 149a-155a.

STATEMENT OF THE CASE

A. Nature of the Case and Jurisdiction Below

This is a securities class action prosecuted on behalf of investors who purchased and sold securities on the NYSE between October 17, 1998, and October 15, 2003, (the Class Period), while the NYSE and its seven Specialist Firms – on whom it has conferred an exclusive franchise to handle the trading in exchange-listed stocks – flouted securities laws and trading rules with a fraudulent course of business that produced enormous profits for themselves, at the expense of innocent public investors. The case arises under the Exchange Act §§6(b), 10(b) and 20(a), 15 U.S.C. §§78f, 78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission ("SEC") 17 C.F.R. §240.10b-5. The district court had jurisdiction under 28 U.S.C. §1331 and §28 of the Exchange Act, 15 U.S.C. §78aa.

After several related cases were consolidated, and Lead Plaintiffs appointed to prosecute the matter, claims against the NYSE's Specialist Firms that survived motions to dismiss are proceeding in the district court. *See* Pet. App. 107a; *see also LaBranche*, 405 F. Supp. 2d 333; *Van der Moolen Holding*, 405 F. Supp. 2d 388. Most claims against the NYSE itself, however, were dismissed with prejudice. *See* Pet. App. 67a-75a.

Following the December 13, 2005, dismissal with prejudice of plaintiffs' claims against the NYSE, Pet. App. 30a-135a, the NYSE joined in Lead Plaintiffs'

request for certification and entry of final judgment under Fed. R. Civ. P. 54(b). Finding no just reason for delay, the district court granted the Rule 54(b) certification, directing the clerk to enter final judgment, which the clerk did on February 17, 2006. Pet. App. 136a-144a. Plaintiffs timely filed a notice of appeal on March 3, 2006. The Second Circuit had jurisdiction under 28 U.S.C. §1291 to review a final judgment.

B. Statement of Facts

The Lead Plaintiffs' Consolidated Complaint alleges in detail how the NYSE and its Specialist Firms executed a fraudulent scheme and course of business designed to cheat public investors and enrich themselves. JA2:70-72 (¶¶2-3).[2] It sets forth how the NYSE falsified trading records, tipped off the Specialist Firms to pending investigations so that fraudulent practices could be concealed, and worked with its specialists to hide evidence of wrongdoing from the SEC. JA2:121-22 (¶116), 123-24 (¶¶121-126). Moreover, while the scheme was in full operation, NYSE officials falsely assured investors that they were in fact operating a fair and orderly market. JA2:82 (¶18(a)).

1. The NYSE's Operation and the Specialist Firms

During the Class Period, the NYSE had only seven Specialist Firms that together managed the trading for all of the NYSE's 2,800 listed companies. JA2:93 (¶32). These Specialist Firms owned many seats on the NYSE trading floor, from which they conducted

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[2] The operative complaint appears in the Second Circuit Joint Appendix at tab 2, and is cited herein as "JA2:__-__ (¶¶__)."

auction markets in particular securities. JA2:82 (¶18(b)), 98 (¶47). The stock of each NYSE-listed company was assigned to one of the Specialist Firms, which then conducted the trading of that company's securities, receiving and processing trading orders on an electronic workstation "Display Book" containing all electronic orders entered into the NYSE's "SuperDot" order-processing system. JA2:96-97 (¶43).

The seven Specialist Firms performed four functions. First, they acted as auctioneers, by continually quoting the best-available prices on a particular stock throughout the trading day. JA2:98 (¶47). Specialist Firms also were required to act as agents, matching the orders of buyers and sellers to ensure timely execution at the best-available price. *Id.* When it was not possible to match buy and sell orders, Specialist Firms were to act as principals, by buying and selling their own holdings of a security in order to maintain liquidity and price continuity. *Id.* Finally, the Specialist Firms acted as catalysts by using their knowledge of interested parties and potential offers to bring buyers and sellers together. *Id.*

Each trading day, billions of shares were bought and sold through the Specialist Firms in NYSE's auction market. JA2:82 (¶18(a)). The NYSE received substantial fees from these trades, JA2:93-84 (¶18(d)), and its executives' continuing employment and compensation were directly tied to the operations of the Specialist Firms. JA2:181 (¶189).

2. The NYSE Abandons Its Regulatory Duties to Foster a Fraudulent Course of Business

Although the NYSE is charged with obeying the securities laws and its own rules, and also with en-

forcing compliance by its members with those provisions, *see* 15 U.S.C. §78s(g)(1), the NYSE effectively abandoned its regulatory function before and during the Class Period, in order to actively encourage and participate with its Specialist Firms in acts of manipulation, a scheme to defraud, and a course of business that operated as a fraud and deceit on public investors trading on the NYSE. JA2:93-85 (¶¶18(d)-(e)), 182 (¶¶191-192).

Rather than regulating them, the NYSE actively engaged with its Specialists in wide-ranging manipulative, self-dealing, deceptive and misleading conduct – thereby violating several sections of the Exchange Act, SEC rules, and NYSE rules. JA2:71-72 (¶3). The wrongs alleged included:

> "interpositioning" in which a Specialist "steps in the way" of matching orders of public sellers and buyers of stock in order to generate riskless profits for itself to the detriment of Class members;
>
> "trading ahead" or "front-running," in which Specialists trade for their own account before completing orders of public investors by taking advantage of their confidential knowledge of public investors' orders that will impact the price of the stock;
>
> "freezing the book," in which a Specialist freezes its Display Book on a stock so it can first engage in trades for its own account before executing public investors' orders; and
>
> manipulating the "tick" or the price of a stock to effect principal trades.

See id.; JA2:109-24 (¶¶75-126).

The NYSE and its Specialist Firms falsified trade records and reports to conceal these illegal and manipulative practices. JA2:71-72 (¶3), 120-24 (¶¶110-126). The Specialist Firms profited by hundreds of millions of dollars from this fraudulent scheme and course of business, and the NYSE paid its top executives exorbitant compensation packages. JA2:71 (¶3), 190 (¶217).

The NYSE thus effectively abandoned its delegated regulatory functions, and engaged instead in improper and illegal conduct far beyond – and utterly inconsistent with – the regulatory authority delegated to it under the Exchange Act. For example, NYSE officials routinely tipped off Specialists ahead of impending investigations, so that the Specialists could cover the tracks of their improper and illegal conduct. JA2:121-22 (¶116). Toni-Ann Turco, who had previously worked in the NYSE Division of Market Surveillance, during the Class Period worked as the head of one Specialist Firm's compliance department – where she was tipped off to investigations by the NYSE's Lucy Palmieri. *Id.* Turco often bragged that "'it pays to have friends at the Exchange.'" *Id.* (citation omitted).

The NYSE worked with the Specialist Firms to facilitate improper trading by helping to doctor the Specialist Firms' weekly trading reports to create records of fictitious trades and conceal the improper trading. JA2:123-24 (¶¶121-126). The NYSE did this by flagging the individual specialists' weekly transaction reports containing improper trading, alerting the Specialists to the problem, then giving the Specialists the rest of the week to "correct" the reports – allowing them to violate NYSE trading rules, cover up the violations, and escape without any penalty. *Id.*

The NYSE – through Richard Grasso himself – also strongly encouraged the Specialists to engage in "freezing the book" on a regular basis, while the NYSE's public-relations people simultaneously told public investors that "there was no such thing . . . as 'freezing the book.'" JA2:115-17 (¶¶91-98) (citation omitted).

3. The SEC Finds that the NYSE Abandoned Its Duties

In early 2003, the SEC finally conducted an investigation of the NYSE and its Specialists because the NYSE, a *self-regulatory organization*, had refused to conduct a genuine investigation into complaints regarding its own improper conduct. JA2:73 (¶7). *The Wall Street Journal* in a November 3, 2003, article, reported that the SEC found that investors were shortchanged by millions of dollars in trades involving more than two billion shares during the Class Period. JA2:74-77 (¶8), 199-200 (¶¶230-233),). *The Wall Street Journal* reported that the SEC had "'blasted the New York Stock Exchange,'" painting a picture of a floor-trading system "'riddled with abuses.'" JA2:74-77 (¶8) (citation omitted). The NYSE itself had fostered abuse – including blatant rule violations by its Specialists – creating and following unwritten policies about the amount of fraud it would allow, and granting "grace periods" during which its Specialists could with impunity violate NYSE rules and the federal securities laws. JA2:74-77 (¶8), 190-95 (¶¶218-220).[3] Abusive business practices and the fraudulent scheme flourished on the

[3] This was only the latest in a history of malfeasance and abuse at the NYSE. The SEC had in 1999 cited the NYSE for knowledge of illegal trading practices. JA2:191-195 (¶¶219-220).

NYSE floor, creating huge profits for the NYSE's Specialist Firms, at enormous cost to public investors.

On March 30, 2004, and on July 26, 2004, the SEC announced settlements with the NYSE's Specialist Firms, imposing over $245 million in disgorgement and penalties for trading unlawfully for the Specialist Firms' own profit at the expense of public investors. JA2:77-80 (¶¶10-12); *see* JA2:124-26 (¶127), 140-45 (¶131). The Specialist Firms had "'themselves engaged in fraud through that proprietary trading in violation of Exchange Act Section 10(b) and Rule 10b-5.'" JA2:79 (¶ 11) (citation omitted).

An internal SEC report implicated the NYSE itself, which the agency charged with fostering an environment where trading violations were rampant, while displaying "'a habit of ignoring repeat violations by specialist firms.'" JA2:199-200 (¶230) (citation omitted). In utter derogation of its self-regulatory responsibilities, the NYSE itself had tipped off Specialists to investigations, and had facilitated falsification of trading records – making it not a market regulator at all, but a primary participant in fraudulent and unlawful conduct. *See* JA2:121-22 (¶116), 123-24 (¶¶121-126). The NYSE, in effect, abandoned its regulatory duties – publicly assuring investors of the integrity and honesty of its market while simultaneously cheating them out of hundreds of millions (if not billions) of dollars on its rigged market. *See* JA2:71-72 (¶3), 82 (¶18(a)), 182 (¶192).

After the operative Complaint was on file, and while the case was pending before Judge Sweet, the SEC on April 12, 2005, announced the simultaneous filing and settlement of "an enforcement action against the New York Stock Exchange, Inc., finding that the

NYSE, over the course of nearly four years, failed to police specialists, who engaged in widespread and unlawful proprietary trading on the floor of the NYSE." Pet. App. 140a.[4]

The SEC emphasized that the NYSE had in effect abandoned its delegated regulatory function from 1999 through 2003 by failing to police its Specialist Firms: "The Commission found that the NYSE violated §19(g) of the Securities Exchange Act of 1934 by failing to enforce compliance with both the federal securities laws and NYSE rules which prohibit specialists from 'interpositioning' and 'trading ahead' of customer orders." *Id.* The release continued:

> Specifically, the Commission's Order finds that from 1999 through 2003, various NYSE specialists repeatedly engaged in unlawful proprietary trading, resulting in more than $158 million of customer harm. The improper trading took various forms, including "interpositioning" the firms' dealer accounts between customer orders and "trading ahead" for their dealer accounts in front of executable agency orders on the same side of the market. From 1999 through almost all of 2002, the NYSE failed to adequately monitor and police specialist trading activity, allowing the vast majority of this unlawful conduct to continue.

Id. at 2.[5]

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[4] The district court judicially noticed the SEC's April 12, 2005, action, referring to it in the Order appealed from, *see* Pet. App. 10a. The SEC's release (Pet. App. 140a-144a) is available on the Internet at http://www.sec.gov/news/press/2005-53.htm, while the NYSE's press release acknowledging the government's action (Pet. App. 145a-147a) is available on the Internet at http://www.nyse.com/content/articles/111330299300 5.html.

[5] *Id.*; *see id.* at 6 ("The Commission's Order finds that the NYSE violated Section 19(g) of the Exchange Act by failing to

C. Course of Proceedings

Following the initial disclosures of the SEC's investigation of the NYSE and its Specialist Firms, investors who during the Class Period had purchased or sold securities on the NYSE filed several securities-fraud actions in late 2003. The district court consolidated the actions, appointing statutory "lead plaintiffs." *See* 15 U.S.C. §78u-4(a)(3)(B)(iii). The country's largest public-employee retirement system, with nearly 1.4 million beneficiaries and assets exceeding $166 billion at the time, Lead Plaintiff CalPERS during the Class Period had bought or sold nearly three billion NYSE-listed shares in transactions executed by the NYSE's Specialist Firms.[6]

A Consolidated Complaint filed on September 16, 2004, charged the NYSE and its Specialist Firms with various securities violations over a Class Period running from October 17, 1998 to October 15, 2003, JA2, seeking relief under §§10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder. JA2:202-04 (¶¶234-244).

Both the Specialist Firms and the NYSE moved to dismiss the Complaint, on a variety of grounds, with the NYSE asserting that it was entitled to absolute immunity based on its status under the Exchange Act as a self-regulatory organization or "SRO." *See* 15 U.S.C. §78c(a)(26). The district court agreed with the NYSE, citing *D'Alessio v. NYSE*, 258 F.3d 93, 106 (2d

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enforce compliance with the federal securities laws and NYSE rules that prohibit unlawful proprietary trading by specialists – specifically, Section 11(b) of the Exchange Act, Rule 11b-1 thereunder, and NYSE Rules 92 and 104.10.").

[6] JA2:81 (¶17(a)). CalPERS' assets currently exceed $200 billion.

Cir. 2001), which held that "'the NYSE, when acting in its capacity as a[n] SRO, is entitled to immunity from suit when it engages in conduct consistent with the quasi-governmental powers delegated to it pursuant to the Exchange Act and the regulations and rules promulgated thereunder.'" Pet. App. 68a (quoting *D'Alessio*, 258 F.3d at 106).

The district court acknowledged the SEC's findings that NYSE had *failed to regulate* its Specialist Firms, but ruled the NYSE is absolutely immune to suit – reasoning that the NYSE's *failure to regulate*, and actual *participation in unlawful conduct*, somehow came within the legitimate scope of the regulatory authority delegated to it by the SEC. Pet. App. 68a-75a.

The Second Circuit affirmed. "Although the NYSE is not a government entity," the court explained, "we have recognized that in certain circumstances it is entitled to absolute immunity for actions it takes pursuant to its quasi-governmental role in the regulation of the securities market." Pet. App. 14a. Citing *Forrester v. White*, 484 U.S. 219, 229 (1988), which *denied immunity* to a state-court judge who had dismissed a subordinate court employee, the Second Circuit said that "as in other absolute immunity contexts, we focus on 'the nature of the function performed, not the identity of the actor who performed it.'" Pet. App. 14a. "Thus," the Second Circuit reasoned, "so long as the 'alleged misconduct falls within the scope of the quasi-governmental powers delegated to the NYSE,' absolute immunity attaches." Pet. App. 15a.

The court held, however, that the NYSE acts within the scope of its quasi-governmental delegated powers even when it actually *abandons* its role as a

regulator, to join its Specialist Firms in a fraudulent scheme:

> Because the allegations demonstrate that the NYSE failed to regulate and at times actually participated in fraud and misconduct, Lead Plaintiffs further contend, the doctrine does not bar their claims. We disagree.

Pet. App. 15a.

"The power to exercise regulatory authority necessarily includes the power to take no affirmative action," the Second Circuit explained, holding that the NYSE acts as a regulator even when it chooses *not* to regulate, and to perpetuate a fraud instead. Pet. App. 16a. The appeals court held that allegations that "'the NYSE deliberately failed to halt, expose or discipline the illegal trading practices [of member firms]'" in fact amounted to "a tacit concession that the NYSE's decisions to act (or not to act) . . . is 'consistent with' the powers delegated to it by the SEC." Pet. App. 21a.

The SEC had found "that the NYSE violated Section 19(g) of the Exchange Act by failing to enforce compliance with the federal securities laws and NYSE rules that prohibit unlawful proprietary trading by specialists." Pet. App. 140a, 142a-143a. The Second Circuit concluded that the NYSE's illegal conduct nonetheless qualified as conduct "'consistent with' the powers delegated to it by the SEC." Pet. App. 21a.

REASONS FOR GRANTING THE WRIT

This case presents important questions concerning the availability and scope of absolute immunity for private entities that are supposed to enforce compliance with legal rules and regulations. Specifically, it

presents the question of whether a nongovernmental "Self-Regulatory Organization" or "SRO" such as the NYSE enjoys absolute immunity when it steps out of its role as a regulator to instead foster illegal trading and fraud on investors. This Court's review is badly needed to bring order to a confused field.

The Second Circuit holds, on the one hand, that SROs are purely private, nongovernmental actors utterly beyond the reach of constitutional limitations on governmental power. *See infra* at 15-16. On the other hand, it holds that SROs enjoy absolute immunity when acting or failing to act pursuant to their self-regulatory powers, on the ground that they in fact stand in the shoes of the SEC – exercising delegated governmental powers. *See infra* at 15-16. Commentators have noted an inconsistency here that warrants this Court's review. *See infra* at 17.

With the decision below in this case, moreover, the Second Circuit holds that absolute immunity applies even where the SRO *fails* to regulate itself and in fact – abandoning its self-regulatory functions – actually joins its members in perpetrating a fraud upon investors.

This sweeping doctrine of absolute immunity is utterly at odds with this Court's holding in *Silver v. NYSE*, 373 U.S. 341 (1963), that the NYSE may be liable for unjustified and arbitrary self-regulatory actions, and with its holding in *Richardson v. McKnight*, 521 U.S. 399 (1997), that private companies and their employees are not entitled to the immunity that government actors receive merely because they are performing delegated governmental functions. *See infra* at 17-26. The Second Circuit's sweeping doctrine conflicts as well with this Court's decisions holding that absolute immunity must be

narrowly cabined and carefully limited "to those exceptional situations where it is demonstrated that absolute immunity is essential to the conduct of the public business." *Butz v. Economou*, 438 U.S. 478, 507 (1978). *See infra* at 26-30.

This Court's review is needed to determine the availability and scope of immunity when an SRO abandons its regulatory role and instead facilitates illegal manipulation and fraud. Even if the NYSE should be immune to suit by those it regulates, that should not mean that investors, who are not similarly regulated by the NYSE, cannot sue if the NYSE *abandons* its regulatory duties and steps outside the legitimate scope of its delegated powers to foster, not an honest market, but a scheme by its own Specialist Firms to defraud those who trade on the Exchange.

I. This Court's Review Is Needed to Resolve Inconsistencies in Lower Court Decisions

The Second Circuit and other courts have repeatedly held that an SRO, such as the NYSE, is a purely private, non-governmental private entity, not subject to constitutional limitations on governmental actors. Even when an SRO investigates or disciplines a member specialist or broker, the Second Circuit holds that it acts "in pursuance of its own interests and obligations, not as an agent of the SEC."[7] The Second Circuit has repeatedly held that an SRO "is

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[7] *United States v. Solomon*, 509 F.2d 863, 869 (2d Cir. 1975) (holding that because NYSE does not act on behalf of the government, its investigations are not subject to Fifth Amendment right not to testify against oneself).

not a government functionary"[8] and "not a state actor."[9] The other Circuits are in accord.[10]

But when victims of *deliberate misconduct* by an SRO seek relief for tortious misconduct, the Second Circuit holds that the SRO suddenly "'stands in the shoes of the SEC'" after all and is therefore absolutely immune for its wrongs.[11]

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[8] *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 161-62 (2d Cir. 2002) (no Fifth Amendment rights in NASD investigations because "the NASD itself is not a government functionary").

[9] *Desidario v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999) (expanding upon *Solomon* to hold the NASD is not subject to constitutional restrictions on the exercise of governmental power: "[I]ndeed, we have already ruled that the New York Stock Exchange – a self-regulatory private organization like the NASD – is not a state actor").

[10] *See, e.g.*, *First Jersey Sec., Inc. v. Bergen*, 605 F.2d 690, 699 (3d Cir. 1979) ("NASD is not a state agency; therefore, First Jersey is unable to state a claim under [42 U.S.C.] section 1983."); *Otto v. SEC*, 253 F.3d 960, 965 (7th Cir. 2001) ("we have previously expressed doubt about 'the proposition that the comprehensive regulation of securities exchanges by the federal government would turn those exchanges into government actors'") (citation omitted); *Marchiano v. NASD*, 134 F. Supp. 2d 90, 95 (D.D.C. 2001) ("The court is aware of no case . . . in which NASD Defendants were found to be state actors either because of their regulatory responsibilities or because of any alleged collusion with criminal prosecutors").

[11] Pet. App. 15a (quoting *D'Alessio*, 258 F.3d at 105 (2d Cir. 2001) ("The NYSE, as a SRO, stands in the shoes of the SEC in interpreting the securities laws for its members and in monitoring compliance with those laws."). "'Although the Exchange is a private, rather than a governmental entity,' the Second Circuit held below, "'immunity doctrines protect private actors when they perform important governmental functions.'" Pet. App. 14a (quoting *Barbara v. NYSE*, 99 F.3d 49, 58 (2d Cir. 1996)); *see also DL Capital Group v. NASDAQ Stock Mkt.*, 409 F.3d 93 (2d Cir. 2005); *Sparta Surgical Corp. v. NASD*, 159 F.3d

> 'This inconsistency has created a need for greater enlightenment from the Supreme Court on whether the SROs are indeed private organizations capable of compelling witnesses to waive their Fifth Amendment privilege against self-incrimination and disciplining their membership without due process, whether they are quasi-governmental entities which are absolutely immune from lawsuits when acting in their regulatory capacity under the Exchange Act, or whether they are both.'

William I. Friedman, *The Fourteenth Amendment's Public/Private Distinction Among Securities Regulators in the U.S. Marketplace – Revisited*, 23 Ann. Rev. Banking & Fin. L. 727, 767 (2004).

II. This Court's Review Is Needed to Clarify the Scope of Absolute Immunity for Nongovernmental Actors

More than an inconsistency in lower-court precedents is at stake here, for the opinion below directly conflicts with what this Court has held regarding the availability of immunity to the NYSE itself in *Silver*, 373 U.S. 341, with what it has said, more generally, about the availability of immunity to private actors performing public functions, *see Richardson*, 521 U.S. 399, and with its holdings that absolute immunity should be strictly limited to "those exceptional situations where it is demonstrated that absolute immunity is essential to the conduct of the public business." *Butz*, 438 U.S. at 507.

1209, 1213 (9th Cir. 1998); *Austin Mun. Sec., Inc. v. NASD, Inc.*, 757 F.2d 676, 689-90 (5th Cir. 1985).

A. Conflict with *Silver v. NYSE*

In *Silver*, 373 U.S. 341, this Court flatly rejected the NYSE's contention that it was impliedly immune to liability when sued under the antitrust laws by a nonmember broker-dealer who contended that the NYSE and its members had unlawfully acted in restraint of trade by terminating the broker-dealer's access to current quotations without "giving the nonmember notice, assigning him any reason for the action, or affording him an opportunity to be heard." *Id.* at 342-43.

The question presented was "the extent to which the character and objectives of the duty of exchange self-regulation contemplated by the Securities Exchange Act are incompatible with the maintenance of an antitrust action" by one denied any notice or opportunity to be heard before being ruled unfit to do business with the NYSE's members. *Id.* at 358. This Court held that the NYSE *could be liable* to the broker-dealer for exercising its self-regulatory powers in an arbitrary and unlawful fashion.

The Court acknowledged "that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." *Id.*, at 361. "The final question," however, was "whether the act of self-regulation in this case was so justified." *Id.* This Court held it was not, because the NYSE had exercised its self-regulatory authority arbitrarily: "Notwithstanding their prompt and repeated requests, petitioners were not informed of the charges underlying the decision to invoke the Exchange rules and were not afforded an appropriate opportunity to explain or refute the charges against them." *Id.*

This Court held that "no justification can be offered for self-regulation conducted without provision for some method of telling a protesting nonmember why a rule is being invoked so as to harm him and allowing him to reply in explanation of his position." *Id.*

> Indeed, the aims of the statutory scheme of self-policing – to protect investors and promote fair dealing – are defeated when an exchange exercises its tremendous economic power without explaining its basis for acting, for the absence of an obligation to give some form of notice and, if timely requested, a hearing creates a great danger of perpetration of injury that will damage public confidence in the exchanges.[12]

The NYSE objected that "disclosure of the reasons for its action and of the sources of its information will subject it and its informants to a risk of being sued for defamation." *Id.* n.14. This Court found any such risk was adequately met not by any sweeping doctrine of absolute immunity, but "by the flexibility inherent in the law of defamation in the concept of the conditional or qualified privilege." *Id.* (citing 1 Harper & James, *The Law of Torts* §§5.21, 5.25, 5.26 (1956)).

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[12] *Id.* The Court added:

> In addition to the general impetus to refrain from making unsupportable accusations that is present when it is required that the basis of charges be laid bare, the explanation or rebuttal offered by the nonmember will in many instances dissipate the force of the *ex parte* information upon which an exchange proposes to act. The duty to explain and afford an opportunity to answer will, therefore, be of extremely beneficial effect in keeping exchange action from straying into areas wholly foreign to the purposes of the Securities Exchange Act.

Id. at 362.

Summing up, this Court held that "Congress in effecting a scheme of self-regulation designed to insure fair dealing cannot be thought to have sanctioned and protected self-regulative activity when carried out in a fundamentally unfair manner." *Silver*, 373 U.S. at 364.

Thus, this Court has clearly held that the NYSE may be liable for misconduct in connection with the execution of its self-regulatory functions. Conflict between *Silver* and the lower court's creation of a sweeping doctrine of absolute immunity warrants this Court's review.

B. Conflict with *Richardson v. McKnight*

The Second Circuit has ruled that, as a nongovernmental private entity to which some quasi-governmental functions have been delegated, the NYSE must be entitled to the same broad governmental immunity that would be accorded a genuine government actor. Yet this Court rejected precisely that viewpoint, holding in *Richardson,* 521 U.S. 399, that even if prison officials ordinarily are entitled to qualified immunity as government actors, *see Procunier v. Navarette*, 434 U.S. 555 (1978), when the manifestly public function of operating prisons is delegated to private companies, the immunity vanishes. *Richardson*, 521 U.S. at 401. Lower courts have similarly held, in other contexts, that immunity does not attach to private companies merely because they are performing functions to which immunity attaches when performed by governmental agencies or their employees.[13]

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[13] *See, e.g., Ace Bev. Co. v. Lockheed Info. Mgmt. Servs.*, 144 F.3d 1218, 1219-20 (9th Cir. 1998) (no qualified immunity for

This Court was urged in *Richardson* to apply a "functional" approach to determine that a private entity performing delegated governmental functions should be entitled to the same immunity as governmental functionaries engaged in similar activities. That is exactly the approach embraced by the Second Circuit in this case, when it held that "we focus on 'the nature of the function performed, not the identity of the actor who performed it,' in order to determine whether an SRO, such as the Exchange, is entitled to immunity." Pet. App. 14a (quoting *Forrester*, 484 U.S. at 229, and following *D'Alessio*, 258 F.3d at 104-06).

But to embrace such an approach, this Court held in *Richardson*, is "to misread this Court's precedents." 521 U.S. at 408. "The Court has sometimes applied a functional approach in immunity cases, but only to decide which type of immunity – absolute or qualified – a public officer should receive." *Id.* at 408 (citing, *e.g.*, *Forrester*). That does not mean such a functional analysis applies where the party who claims immunity is *not* a public official. *Id.* "Indeed a purely functional approach bristles with difficulty, particularly since, in many areas, government and private industry may engage in fundamentally similar activities, ranging from electricity production, to waste disposal, to even mail delivery." *Id.* at 409.

This Court explained in *Richardson* that the need for governmental immunities is greatly reduced when

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Lockheed in connection with its enforcement of parking regulations); *Hepting v. AT&T Corp.*, 439 F.Supp 2d 974, 1006-10 (N.D. Cal. 2006) (Hon. Vaughn R. Walker, district judge) (no qualified immunity for AT&T in connection with its surveillance of customer communications on behalf of the government), *appeal pending* 9th Cir. Nos. 06-17132, 06-17137.

public functions are delegated to private companies competing in the marketplace, where they are "subject to the ordinary competitive pressures that normally help private firms adjust their behavior in response to the incentives that tort suits provide – pressures not necessarily present in government departments." *Richardson*, 521 U.S. at 409, 412. The NYSE is such an entity operating in the marketplace and subject to ordinary competitive pressures. Though nominally a non-profit corporation during the Class Period, it was planning to reorganize and operate as a for-profit company, and was in effect really operating as a private enterprise for the benefit of its members and officers.

It currently is a for-profit company competing with other organizations – such as the American Stock Exchange and NASDAQ – to provide a market for securities. The NYSE is, indeed, one of ten securities exchanges registered with the SEC as national securities exchanges.[14] Its major competitor, The Nasdaq Stock Market LLC is a publicly traded for-profit company whose stock trades under the ticker symbol NDAQ. Since 1998, moreover, the registered exchanges' competitors have included Alternative Trading Systems and Electronic Communications Networks, or ECNs, as defined in Rule 600(b)(23) of Regulation NMS, that operate as electronic trading systems automatically matching buy and sell

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[14] They are: American Stock Exchange; Boston Stock Exchange; Chicago Board Options Exchange; Chicago Stock Exchange, International Securities Exchange; National Stock Exchange (formerly the Cincinnati Stock Exchange), The Nasdaq Stock Market LLC; New York Stock Exchange; NYSE Arca (formerly the Pacific Exchange); and Philadelphia Stock Exchange. *See* http://www.sec.gov/ answers/exchanges.htm.

orders.[15] Examples include Instinet, a wholly owned subsidiary of Nomura Holdings, Inc. Competition is so stiff, according to the financial press, that the American Stock Exchange, which has been struggling to compete with upstart electronic exchanges, now is in merger negotiations with the NYSE Euronext (NYX), the NYSE's parent holding company.[16]

Thus, the very sort of competitive market forces cited in *Richardson* are present here and weigh against immunity of any kind – particularly given the Second Circuit's rationale of affording absolute immunity "so that SROs will not be excessively timid in their regulatory decisions." Pet. App. 17a. In *Richardson*, this Court held that this rationale overlooks "certain important differences that, from an immunity perspective, are critical." 521 U.S. at 409.

> First, the most important special government immunity-producing concern – unwarranted timidity – is less likely present, or at least is not special, when a private company subject to competitive market pressures operates a prison. Competitive pressures mean not only that a firm whose guards are too aggressive will face damages that raise costs, thereby threatening its replacement, but also that a firm whose guards are too timid will face threats of replacement by other firms with records that demonstrate their ability to do both a safer and more effective job.

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[15] *See* http://www.see.gov.divisions/marketreg/mrcen.shtml; Exchange Act Rel. No. 37619A, http://www.sec.gov/rules/final/37619a.txt; Exchange Act Rel. No. 51808, http://www.sec.gov/rules/final/34-51808.pdf.

[16] *See* Steven M. Sears, *What Amex Brings to NYSE*, Barron's January 14, 2008, http://online.barrons.com/article/SB120009540845484983.html.

Richardson, 521 U.S. at 409. "In other words, marketplace pressures provide the private firm with strong incentives to avoid overly timid, insufficiently vigorous, unduly fearful, or 'nonarduous' employee job performance." *Id.* at 410.

Addressing the availability of either qualified or absolute immunity, moreover, this Court first has "generally looked for a historical or common-law basis for the immunity in question." *Mitchell v. Forsyth*, 472 U.S. 511, 521 (1985). "History," it found in *Richardson*, "does *not* reveal a 'firmly rooted' tradition of immunity applicable to privately employed prison guards." 521 U.S. at 404 (Court's emphasis). For reported nineteenth century precedents included suits against privately operated prisons, with "no evidence that the law gave purely private companies or their employees any special immunity from such suits." *Id.* at 406.

Much the same may be said of securities or commodities exchanges, which often were subjects of a suit in connection with the operation of their markets and the regulation of members. Even those whom the exchanges regulated could file suit and recover damages for arbitrary or improper self-regulatory actions.[17] When suits against commodities exchanges or stock exchanges were dismissed, it was on their merits, not because the exchange enjoyed any immu

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[17] *See, e.g.*, *Fisher v. Board of Trade*, 80 Ill. 85, 86-87 (1875) (denying equitable relief to trader expelled by Board of Trade but upholding an award of damages "assessed, under the proofs heard on that question, at five hundred dollars"; "We perceive no error in assessing damages. The proof sustains the amount found as damages.").

nity from suit, whether qualified or absolute.[18] Many decisions denied equitable relief, to be sure, but typically on the ground that adequate relief was available at law.[19]

The conflict of the rationales offered below for the Second Circuit's doctrine of absolute immunity with the contrary analysis of *Richardson*, warrants this Court's review.

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[18] *See, e.g., Ulery v. Chicago Live Stock Exchange*, 54 Ill. App. 233, 238-39 (1894) (suit by livestock broker against Live Stock Exchange that directed its members not to transact business with him dismissed because no libel was shown). In *Cohen v. Thomas*, 209 N.Y. 407, 103 N.E. 708 (N.Y. 1913), a broker filed suit seeking reinstatement as a member of the NYSE after being expelled for making a material misstatement when applying for membership. New York's highest court held that the lower court properly entertained and resolved the suit in the NYSE's favor, explaining that an Exchange's disciplinary ruling shall be upheld "unless it is made to appear that the proceedings were contrary to natural justice, or that the decision was not come to in good faith." 209 N.Y. at 410. "Associations, such as the New York Stock Exchange, which exist by virtue of the compact of its members and not by any force of statutory incorporation, will be left for their internal governance to the regulations agreed upon and those will be allowed effect, so far as they do not violate any rules of law, or of natural justice." 209 N.Y. at 411. "That the proceedings were in accordance with the constitution and that the Committee acted in good faith, without prejudice, or ill will, the court has, expressly, found." *Id.*

[19] *Baxter v. Board of Trade*, 83 Ill. 146, 148 (1876) (following *Fisher*: "If appellant has any remedy in the courts for his supposed illegal expulsion from the board of trade, his remedy is at law and not in equity by injunction."); *Sturges v. Board of Trade*, 86 Ill. 441, 442 (1877) (holding that under *Baxter*, 83 Ill. 146, "even if a member may resort to the courts for a remedy in such cases, he must go to a court of law").

C. Conflict with *Butz v. Economou* and Its Progeny

Under this Court's precedents the availability of *absolute* immunity is even more narrowly constrained than is the mere *qualified immunity* with which *Richardson* dealt. This Court has denied absolute immunity even to top Presidential aides and cabinet members. *Harlow v. Fitzgerald*, 457 U.S. 800, 807 (1982). It holds that the Attorney General of the United States is not "absolutely immune from suit for actions undertaken in the interest of national security." *Mitchell*, 472 U.S. at 513.

For absolute immunity, this Court has repeatedly emphasized, must be limited "to those exceptional situations where it is demonstrated that absolute immunity is essential for the conduct of the public business." *Butz*, 438 U.S. at 507; *see, e.g.*, *Cleavinger v. Saxner*, 474 U.S. 193, 201 (1985) (quoting *Butz*). It is doubtful, however, that immunity for an SRO that abandons its regulatory functions and joins in a scheme to defraud investors, is "essential for the conduct of the public business." *Butz*, 438 U.S. at 507.

The fact that the NYSE is supposed to exercise extensive enforcement responsibilities does not mean that it must be absolutely immune for actions in derogation of those responsibilities – even if it sometimes plays a quasi-prosecutorial or adjudicative role.

With the principle of "judicial immunity firmly established, the Court has extended absolute immunity to certain others who perform functions closely associated with the judicial process." *Cleavinger*, 474 U.S. at 200. Thus, the Court accorded absolute immunity to a federal hearing examiner and administrative law judge in *Butz*, 438 U.S. 478, choosing absolute over qualified immunity for these public officials, because

"the role of the modern federal hearing examiner or administrative law judge . . . is 'functionally comparable' to that of a judge." *Id.* at 513. But this has never meant that all public officials performing some prosecutorial or adjudicatory role are entitled to absolute immunity, let alone that private entities must be.

This Court has, indeed, repeatedly rejected contentions that even public officials performing quasi-prosecutorial or adjudicatory functions are necessarily entitled to absolute immunity. In *Wood v. Strickland*, 420 U.S. 308 (1975), for example, school-board members functioned as "adjudicators in the school disciplinary process," and were to "judge whether there have been violations of school regulations and, if so, the appropriate sanctions for the violations." *Id.*, at 319. This adjudicative function did not entitle board members to absolute immunity. *See id.*

Similarly, in *Cleavinger*, 474 U.S. 193, this Court held that members of a federal prison's Institution Discipline Committee were not entitled to absolute immunity for their actions in proceedings disciplining prison inmates for alleged infractions of prison rules and regulations. Members of the Disciplinary Committee urged "that the Court's cases teach that absolute immunity shields an official if (a) the official performs an adjudicatory function comparable to that of a judge, (b) the function is of sufficient public importance, and (c) the proper performance of that function would be subverted if the officials were subject to individual suit for damages." *Id.* at 202-03. This Court acknowledged that "[t]he committee members, in a sense, do perform an adjudicatory function in that they determine whether the accused inmate is

guilty or innocent of the charge leveled against him; in that they hear testimony and receive documentary evidence; in that they evaluate credibility and weigh evidence; and in that they render a decision." *Id.* at 203. Yet they were not therefore entitled to absolute immunity.

In the past, even the Second Circuit specified that the NYSE may assert absolute immunity *only* for actions undertaken "*when acting in its capacity as a SRO*," and *only* to the extent that it "*engages in conduct consistent with the quasi-governmental powers delegated to it* pursuant to the Exchange Act and the regulations and rules promulgated thereunder." *D'Alessio*, 258 F.3d at 106 (emphasis added). Yet, the Second Circuit in this case ruled that the NYSE is absolutely immune from suit even when it effectively *abandons* its regulatory functions in order to facilitate fraud.

The fact that the SEC had to intervene to enforce the law – upbraiding the NYSE for *failure to act as a regulator* – suggests that the NYSE was *not* in fact "acting in its capacity as a SRO," *D'Alessio*, 258 F.3d at 106, but was instead abandoning its legitimate functions. Indeed, the SEC cited the NYSE for ignoring its Exchange Act responsibilities by systematically "failing to enforce compliance with the federal securities laws and NYSE rules." Pet. App. 140a, 142a-143a. Fostering a dishonest market in this fashion is by no means conduct consistent with the NYSE's delegated powers, *D'Alessio*, 258 F.3d at 106, let alone "essential for the conduct of the public business." *Butz*, 438 U.S. at 507.

Other decisions recognizing *absolute immunity* for an SRO generally accord its protection only to those who are *actually performing an adjudicative or prose-*

cutorial function, or acting in a law-making (or rule-making) quasi-legislative capacity.[20] Those cases involved assertions *by regulated parties* that the NYSE was liable to them for how it had conducted itself as a prosecutor or judge. In *DL Capital*, moreover, the Second Circuit ruled that *investors* may not sue the NASDAQ *for an exercise of regulatory authority* on the theory that it should have announced the cancellation of trades with greater speed.

If absolute immunity applies to protect the *exercise of prosecutorial, adjudicative and legislative functions*, its rationale ought not reach situations where, as here, the SRO has effectively *abandoned* its regulatory function – requiring the SEC to step in and discipline Specialist Firms who had been given free rein by the Exchange to cheat investors.

Engaging in fraud, obstructing justice, and facilitating deception and violation of our nation's securities laws, rules and regulations, is conduct by no means "consistent with the quasi-governmental powers delegated" by law to the NYSE. *Id.* It is conduct directly *contrary* to and entirely beyond the quasi-governmental power delegated to the NYSE, and

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[20] *See DL Capital*, 409 F.3d 93 (immunity for applying its rules and regulations); *D'Alessio*, 258 F.2d at 97-98 (SRO faced no liability to disciplined stockbroker because it had "acted in its adjudicatory capacity when it determined that D'Alessio was guilty of violating [Exchange Act] section 11(a) and various rules of the NYSE and suspended him from further trading on the NYSE floor"); *Barbara*, 99 F.3d 49, (action by disciplined stockbroker barred); *Austin*, 757 F.2d at 688 (noting that absolute immunity is limited to "judges, . . . prosecutors, . . . legislators, . . . and legislative aides acting in their legislative capacity"); *see also Butz*, 438 U.S. at 511-17 (affording absolute immunity to administrative-law judges and prosecutors).

protecting it is contrary to the Exchange Act's fundamental purpose – of ensuring that investors may trade in an honest market. *See, e.g.*, *Basic Inc. v. Levinson*, 485 U.S. 224, 230, 245-47 (1988).

The Second Circuit's radical expansion of absolute immunity in this case warrants this Court's attention, where the NYSE was clearly not discharging its duties under the Exchange Act by engaging in fraud, obstructing justice, and facilitating deception and violation of our nation's securities laws, rules, and regulations.

CONCLUSION

For all the foregoing reasons, a writ should issue to review the decision below.

Respectfully submitted,

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January 16, 2008

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Docket No. 06-1038-cv

IN RE: NYSE SPECIALISTS SECURITIES LITIGATION (CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, AND EMPIRE PROGRAMS, INC., LEAD PLAINTIFFS-APPELLANTS, V. NEW YORK STOCK EXCHANGE, INC., DEFENDANT-APPELLEE).*

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503 F.3d 89

February 26, 2007, Argued
September 18, 2007, Decided

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* The Clerk of Court is directed to amend the official caption in conformance with the one listed above.

Before: JACOBS, Chief Judge, LEVAL and SOTOMAYOR, *Circuit Judges*.

Lead plaintiffs-appellants ("Lead Plaintiffs") appeal from a judgment of the United States District Court for the Southern District of New York (Sweet, J.), granting *defendant-appellee* the New York Stock Exchange, Inc.'s (the "NYSE" or the "Exchange") motion to dismiss the complaint, which alleged various violations of the Securities Exchange Act of 1934 (the "Exchange Act"), stemming from claims that the NYSE failed to regulate and provide a fair

and orderly market and from a claim under Rule 10b-5, 17 C.F.R. §240.10b-5, that the NYSE made misrepresentations about the integrity of its market, upon which Lead Plaintiffs relied in trading on the NYSE. We agree with the district court that Lead Plaintiffs' claims concerning the Exchange's alleged regulatory failures were barred by the doctrine of absolute immunity, but we vacate the district court's ruling that Lead Plaintiffs lacked standing to bring suit under the Exchange Act or Rule 10b-5 for the NYSE's purported misrepresentations concerning the NYSE's market integrity and internal operations and remand for proceedings consistent with this opinion.

Affirmed in part, VACATED in part and REMANDED

ERIC ALAN ISAACSON (William S. Lerach, Mark Solomon, Byron S. Georgiou, William J. Doyle II, Tami Falkenstein Hennick, Lucas F. Olts, *on the brief*), Lerach Coughlin Stoia Geller Rudman & Robbins LLP, San Diego, CA; and Christopher Lovell, Imtiaz A. Siddiqui, *on the brief*, Lovell Stewart Halebian LLP, New York, NY, *for Lead Plaintiffs-Appellants*.

DEBRA M. TORRES, Fried, Frank, Harris,

Shriver & Jacobson LLP, New York, NY, *for Defendant-Appellee*.

OPINION

SOTOMAYOR, *Circuit Judge*:

Lead plaintiffs-appellants California Public Employees' Retirement System ("CalPERS") and Empire Programs, Inc. ("Empire") (collectively "Lead Plaintiffs") appeal from a judgment of the United States District Court for the Southern District of New York (Sweet, J.), *In re NYSE Specialists Sec. Litig.*, 405 F. Supp. 2d 281 (S.D.N.Y. 2005) ("*In re NYSE Specialists*"), granting defendant-appellee New York Stock Exchange, Inc.'s (the "NYSE" or the "Exchange") motion to dismiss Lead Plaintiffs' claims that the NYSE failed to regulate and provide a fair and orderly market and their claim under Rule 10b-5, 17 C.F.R. § 240.10b-5, that the NYSE made misrepresentations about the integrity of its market, upon which Lead Plaintiffs relied in trading on the NYSE. Lead Plaintiffs argue that the district court erred in finding that the NYSE is entitled to absolute immunity because, having abandoned its regulatory role to maintain a fair and orderly market, the NYSE was not acting consistently with the quasi-governmental powers delegated to it when it permitted and encouraged misconduct and fraud on its trading floor. Lead Plaintiffs further contend that the district court erred by finding that they lacked standing under *Rule 10b-5* to bring suit against the Exchange for purported misrepresentations about its integrity and internal operations, upon which Lead Plaintiffs relied in trading on the NYSE. For the reasons to be discussed, we affirm the judgment of the district court as to the NYSE's absolute immunity for its alleged regulatory failures, but vacate the district court's ruling that Lead Plaintiffs lacked

standing under *Rule 10b-5* and remand for further proceedings consistent with this opinion.

BACKGROUND

Because this appeal challenges the grant of a motion to dismiss, we must take the facts alleged in the complaint as true, drawing all reasonable inferences in Lead Plaintiffs' favor. *See Port Wash. Teachers' Ass'n v. Bd. of Educ.*, 478 F.3d 494, 498 (2d Cir. 2007). Taken in this light, the facts are as follows.

The NYSE is registered with the Securities and Exchange Commission ("SEC") as a national securities exchange pursuant to section 6 of the Exchange Act, 15 U.S.C. § 78f. As a registered exchange, the NYSE is deemed by the Exchange Act a self-regulatory organization ("SRO"), *see* 15 U.S.C. § 78c(a)(26), which means that the Exchange "has a duty to promulgate and enforce rules governing the conduct of its members."*Barbara v. N.Y. Stock Exch., Inc.*, 99 F.3d 49, 51 (2d Cir. 1996). We have previously noted that the SEC has delegated to the NYSE "substantial authority . . . to regulate [its] own conduct and that of [its] members." *MFS Secs. Corp. v. N.Y. Stock Exch.*, 277 F.3d 613, 615 (2d Cir. 2002).

The NYSE and the Specialist Firms

According to the complaint, the NYSE was at all times relevant to the action (the "Class Period") a nonprofit corporation, charged with overseeing the world's largest stock exchange, which lists over 2,800 publicly traded companies.[1] The NYSE is organized

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[1] The Exchange is no longer a nonprofit corporation, following a merger which commenced after the filing of this lawsuit. The NYSE now

under the principle that investors in the companies traded on its floor, whether individual or institutional, are entitled to equal opportunities to interact and receive the best prices available on their trades. Because the Exchange itself does not execute the actual trading in these 2,800 companies, it facilitates this auction market by funneling trades through seven Specialist Firms (the "Specialist Firms" or the "Firms"), which are charged with managing "the stocks assigned to them to create a fair, competitive, orderly and efficient market." Consolidated Compl. P 37.

Each security listed for trading on the NYSE is assigned to a particular Firm. To execute purchases and sales of a particular security, buyers and sellers must present their bids to buy and offers to sell to the specific Specialist Firm assigned to that security. The primary method of trading on the Exchange occurs through the NYSE's Super Designated Order Turnaround System, which transmits orders to buy and sell to the Specialist Firm electronically. The orders appear on a special electronic workstation often referred to as the "display book." Each Specialist Firm has a computerized "display book" at its trading post that permits the Firm to execute orders for the market.

By acting as either the agent for investors or principal for itself in the sale and purchase of the individual securities to which they are each assigned, the Firms are required to make and display continuous two-sided quotations that accurately reflect prevailing market conditions in order to

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operates under the name NYSE LLC as a for-profit entity. NYSE LLC is registered with the SEC under the Exchange Act as an SRO.

maintain a liquid and continuous two-sided public auction. When acting as agent, the Specialist Firms match the orders of buyers and sellers, whose bids and offers appear on the display book, and thus ensure the timely execution of trades at the best available price. When acting as principal, the Specialist Firms

> [a]re permitted to execute, in certain limited circumstances, trades on a "principal" or "dealer" basis, when required to do so to maintain a fair and orderly market. In such circumstances, such as if there were no matching orders to sell and orders to buy, the specialist was permitted to execute an investor's order to buy stock by selling the stock from the specialist's proprietary account, or "inventory" of stock, to the investor. Additionally, the specialist was permitted to execute an investor's order to sell stock by buying that stock and holding the stock in the investor's inventory.

In re NYSE Specialists, 405 F. Supp. 2d at 290.

The substantial powers of, and the near-total control exercised by, the Specialist Firms over any given stock on the NYSE create an opportunity to manipulate the market for self-gain. The complaint alleges that "[t]he Specialist Firm is constantly in a position to trade for its own proprietary accounts while in possession of material non-public information regarding the supply and demand for a given stock, in part through its knowledge of existing but unexecuted" orders. Consolidated Compl. P 52.[2]

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[2] For instance, taking an example from the complaint for illustrative purposes: If a Specialist Firm knew that for one of the stocks assigned to it, 10,000 shares were bid at $ 89.06 and 10,000 shares were offered at $

Cognizant of this risk, the Exchange has promulgated internal rules that govern the conduct of Specialist Firms, including rules that require the Firms to "adhere to the principles of good business practice," NYSE Rule 401(a), and rules that prohibit any Firm from trading on its own account unless it is reasonably necessary to maintain a fair and orderly market, *see, e.g.*, NYSE Rule 104(a) ("No [Specialist Firm] shall effect on the Exchange purchases or sales of any security in which such [Firm] is registered, for any account in which [it] . . . is directly or indirectly interested, unless such dealings are reasonably necessary to permit such [Firm] to maintain a fair and orderly market . . . ."). Thus, Lead Plaintiffs allege that the rules require the Firms to act as principal only in the limited situations where doing so is necessary to maintain a fair and orderly market.

Lead Plaintiffs allege that during the Class Period, the Specialist Firms actively took advantage of their unique position to self-deal and that the NYSE neglected or abandoned its regulatory duties and oversight of the Specialist Firms by permitting and in some cases encouraging blatant self-dealing. Through "wide-ranging manipulative, self-dealing, deceptive and misleading conduct," the Firms and the Exchange allegedly violated several sections of the

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89.00, the Firm, following proper regulatory protocols, should allow the trade to go through at $ 89.03, giving both sides a fair and orderly execution in the public market. According to Lead Plaintiffs' allegations, however, the Specialist Firm would often in such situations act as a principal and buy the 10,000 shares at $ 89.01 and then sell them at $ 89.05. While both the original buyer and seller would receive a $ .01 price improvement on their initial trade positions, the Firm, by acting not as agent but as principal, was able to use non-public bid and offer information to make a $.04 profit per share for itself in a matter of seconds. Consolidated Compl. PP 78-79.

Exchange Act, SEC rules, and the NYSE's own rules and regulations. In the complaint, Lead Plaintiffs alleged five types of misconduct, the first four of which involve the NYSE either turning a blind eye to, or actively encouraging, the Firms' self-dealing:

- "Interpositioning," whereby a Specialist Firm prevented the normal agency trade between matching public orders and instead interposed itself between the matching orders in order to generate profits for itself.
- "Trading ahead," in which a Specialist Firm undertook trades for its own account before undertaking trades for public investors. Because the Specialist Firm knew how the public investors' orders would impact the stock price, it used this confidential knowledge to its own commercial advantage.
- "Freezing the book," whereby a Specialist Firm froze its display book for a given stock in order to engage in trades for its own account first before undertaking any orders for public investors.
- Manipulating the "tick," whereby a Specialist Firm changed the price of the stock to affect principal trades.

The fifth type of misconduct alleged by Lead Plaintiffs involves the effort to conceal evidence of the Specialist Firms' malfeasance, in which the NYSE actively sought to help the Firms skirt or violate the securities laws by, *inter alia*, falsifying reports, tipping off Specialist Firms to impending investigations, and covertly encouraging misconduct. This wide-ranging fraudulent scheme allegedly resulted in hundreds of millions of dollars in illicit profits for the Firms and the NYSE.

The SEC Report and Enforcement Actions Against the NYSE and Specialist Firms

According to the complaint, the "complete and utter failure of the NYSE to regulate the Specialist Firms' conduct during the Class Period" is detailed in a November 3, 2003 *Wall Street Journal* article describing the contents of a confidential SEC report prepared as part of an official SEC investigation of the NYSE and the Firms, begun in early 2003. Consolidated Compl. P 230. The article summarized the report's conclusions about the Exchange's regulatory failures, including that the NYSE had failed "to police its elite floor-trading firms" and "ignor[ed] blatant violations" of prohibitions on self dealing; that the Exchange was "an in-house regulator either ill-equipped or too worried about increasing its workload to care"; and that the NYSE had "no meaningful surveillance, allowing inappropriate behavior to continue" and causing "significant" customer harm totaling in the hundreds of millions of dollars. The SEC report has never been publicly released.

This newspaper article was followed several months later by announcements on March 30, 2004 and July 26, 2004 from the SEC that it had come to settlement agreements with each of the Specialist Firms, in which the Firms acknowledged that they had failed to maintain a fair and orderly market for their assigned securities as required by law. The Specialist Firms consented to the announced settlement, without admitting or denying the findings, that they had violated the Exchange Act through fraud and manipulation. The Firms further agreed to pay to the SEC settlements totaling nearly 250 million dollars for their transgressions.

On April 12, 2005, the SEC announced the simultaneous filing and settlement of "an enforcement action against the New York Stock Exchange, Inc.," which indicated that the

"NYSE consented, without admitting or denying the findings, to entry of an order imposing a censure and requiring the NYSE to cease and desist from future violations of the federal securities laws." Press Release, Sec. & Exch. Comm'n, SEC Charges the New York Stock Exchange with Failing to Police Specialists (Apr. 12, 2005), *available at* http://www.sec.gov/news/press/2005-53.htm. The announcement further noted:

> [s]pecifically, the Commission's Order finds that from 1999 through 2003, various NYSE specialists repeatedly engaged in unlawful proprietary trading, resulting in more than $ 158 million of customer harm. The improper trading took various forms, including "interpositioning" the [F]irms' dealer accounts between customer orders and "trading ahead" for their dealer accounts in front of executable agency orders on the same side of the market. From 1999 through almost all of 2002, the NYSE failed to adequately monitor and police specialist trading activity, allowing the vast majority of this unlawful conduct to continue. The illegal trading went largely undetected because the NYSE's regulatory program was deficient in surveilling, investigating and disciplining the specialists' trading violations.

Id. The Exchange, as a result of this settlement, agreed to implement new oversight methods and to fund their implementation to the sum of $ 20 million.

The Alleged Misrepresentations

Throughout the Class Period, the NYSE repeatedly made public statements about the operations of its Specialist Firms and its oversight of their daily functions. For instance, in a press release dated January 8, 2001, the Exchange allegedly stated: "Our agency-auction model joins the greatest liquidity and transparency with the most efficient method of price discovery, leading to the lowest execution costs and best prices for customers." The NYSE ran advertisements featuring Warren Buffet of Berkshire Hathaway, who touted the savings in transaction costs for his company achieved through listing on the Exchange, and who further observed that "[w]e wanted the best market that we could obtain for our shareholders. The NYSE is that market." Moreover, high-level employees of the Exchange, including its then-Chairman Richard Grasso, issued public statements that assured the public of the NYSE's integrity and its longstanding commitment to an open and fair market. Lead Plaintiffs claim that these statements deliberately created "the false impression that [the Exchange] was overseeing and operating its auction market in accordance with laws, rules and regulations, and l[ed] investors to believe that the NYSE was an honest and fair market," and that they relied on these misstatements in trading stocks listed on the NYSE's exchange during the Class Period.

The Instant Suit

On October 17, 2003, a class action suit was filed in the United States District Court for the Southern District of New York against the Specialist Firms and the NYSE. Several related class actions were also subsequently filed in the same court. On May 27,

2004, the district court entered an order consolidating the related cases, choosing CalPERS and Empire as Lead Plaintiffs, and appointing lead counsel. Lead Plaintiffs filed an amended consolidated complaint, and the defendants, including NYSE, moved to dismiss under Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure. In a published opinion, the district court denied the motions as to the individual defendant Specialist Firms, but granted the NYSE's *Rule 12(b)(6)* motion on the basis that as an SRO, it enjoyed absolute immunity on Lead Plaintiffs' claims that the Exchange had abandoned its regulatory duties and that the Lead Plaintiffs lacked standing under Rule 10b-5, 17 C.F.R. § 240.10b-5, to pursue their misrepresentation claim against the Exchange. *In re NYSE Specialists*, 405 F. Supp. 2d at 302-306. On February 9, 2006, the district court granted the Lead Plaintiffs' motion for certification and entry of final judgment with respect to the NYSE pursuant to Federal Rule of Civil Procedure 54(b). This timely appeal followed.

DISCUSSION

We review *de novo* a district court's grant of a motion to dismiss for failure to state a claim under *Rule 12(b)(6)*. *Nicholas v. Goord*, 430 F.3d 652, 657 (2d Cir. 2005). A court should not dismiss a case on such a motion "unless . . . satisfied that the complaint cannot state any set of facts that would entitle the plaintiff to relief." *Miller v. Wolpoff & Abramson, L.L.P.*, 321 F.3d 292, 300 (2d Cir. 2003). Towards this end, we must accept all allegations in the complaint as true and draw all inferences in the light most favorable to the non-moving party's favor, *Port Wash. Teachers' Ass'n*, 478 F.3d at 498, but we need not accord "[l]egal conclusions, deductions or opinions

couched as factual allegations . . . a presumption of truthfulness,"*United States v. Bonanno Organized Crime Family of La Cosa Nostra*, 879 F.2d 20, 27 (2d Cir. 1989) (internal quotation marks omitted).

We first consider whether the NYSE is entitled to absolute immunity from claims stemming from either the Exchange's active or passive complicity in the Specialist Firms' misconduct, and then turn to address whether Lead Plaintiffs have standing to bring their *Rule 10b-5* claim for the Exchange's alleged misrepresentations concerning its regulatory activities and the integrity of its market.

I. Absolute Immunity

Absolute immunity affords "complete protection from suit," *Harlow v. Fitzgerald*, 457 U.S. 800, 807, 102 S. Ct. 2727, 73 L. Ed. 2d 396 (1982), because it gives "public officials entrusted with sensitive tasks a protected area of discretion within which to carry out their responsibilities," *Barr v. Abrams*, 810 F.2d 358, 361 (2d Cir. 1987), so that they will not feel "constrained in making every decision by the consequences in terms of [their] own potential liability in a suit for damages," *Imbler v. Pachtman*, 424 U.S. 409, 424-25, 96 S. Ct. 984, 47 L. Ed. 2d 128 (1976). The doctrine's nature "is such that it 'accords protection from . . . any judicial scrutiny of the motive for and reasonableness of official action,'" *Shmueli v. City of New York*, 424 F.3d 231, 237 (2d Cir. 2005) (quoting *Robison v. Via*, 821 F.2d, 913, 918 (2d Cir. 1987)), even where the challenged conduct was motivated by a wrongful motive or even malice, *Bernard v. County of Suffolk*, 356 F.3d 495, 503 (2d

Cir. 2004) (citing *Cleavinger v. Saxner*, 474 U.S. 193, 199-200, 106 S. Ct. 496, 88 L. Ed. 2d 507 (1985)). Given this significant protection, we have cautioned that the doctrine "is of a rare and exceptional character." *Barrett v. United States*, 798 F.2d 565, 571 (2d Cir. 1986) (internal quotation marks omitted). As such, courts must examine the invocation of absolute immunity on a case-by-case basis, *DL Capital Group v. NASDAQ Stock Mkt. Inc.*, 409 F.3d 93, 97 (2d Cir. 2005), and the party asserting immunity bears the burden of demonstrating its entitlement to it, *D'Alessio v. N.Y. Stock Exch., Inc.*, 258 F.3d 93, 104 (2d Cir. 2001).

Although the NYSE is not a government entity, we have recognized that in certain circumstances, it is entitled to absolute immunity for actions it takes pursuant to its quasi-governmental role in the regulation of the securities market. *See Barbara*, 99 F.3d at 58 ("Although the Exchange is a private, rather than a governmental entity, immunity doctrines protect private actors when they perform important governmental functions."). Indeed, as in other absolute immunity contexts, we focus on "the nature of the function performed, not the identity of the actor who performed it," *Forrester v. White*, 484 U.S. 219, 229, 108 S. Ct. 538, 98 L. Ed. 2d 555 (1988), in order to determine whether an SRO, such as the Exchange, is entitled to immunity, *see D'Alessio*, 258 F.3d at 104-06 (applying functional approach to determine whether the NYSE was entitled to immunity). Applying this analysis, we have found stock exchange SROs absolutely immune from suit where the alleged misconduct concerned (1) disciplinary proceedings against exchange members, *Barbara*, 99 F.3d at 59; (2) the enforcement of security rules and regulations and general regulatory

oversight over exchange members, *D'Alessio*, 258 F.3d at 106; (3) the interpretation of the securities laws and regulations as applied to the exchange or its members, *id.*; (4) the referral of exchange members to the SEC and other government agencies for civil enforcement or criminal prosecution under the securities laws, *id.*; and (5) the public announcement of regulatory decisions, *DL Capital Group*, 409 F.3d at 98. The common thread in these cases is that absolute immunity attaches where the activity "relate[s] to the proper functioning of the regulatory system." *D'Alessio*, 258 F.3d at 106 (internal quotation marks omitted). Indeed, because

> [t]he NYSE, as a[n] SRO, stands in the shoes of the SEC in interpreting the securities laws for its members and in monitoring compliance with those laws . . . [i]t follows that the NYSE should be entitled to the same immunity enjoyed by the SEC when it is performing functions delegated to it under the SEC's broad oversight authority.

Id. Thus, so long as the "alleged misconduct falls within the scope of the quasi-governmental powers delegated to the NYSE," absolute immunity attaches. *Id.* at 106.

Lead Plaintiffs argue that under our precedents, the doctrine of absolute immunity applies solely when SROs act (1) affirmatively and (2) consistently with the powers delegated to NYSE in its quasi-governmental role. Because the allegations demonstrate that the NYSE failed to regulate and at times actually participated in fraud and misconduct, Lead Plaintiffs further contend, the doctrine does not bar their claims. We disagree.

Lead Plaintiffs first argue that our prior decisions in this area have protected only the affirmative assertion of regulatory power by an SRO and that immunity does not exist where the NYSE does not act and has essentially, in their words, "abandoned" its duty to regulate. In *D'Alessio*, however, we expressly found the NYSE absolutely immune where plaintiff complained of NYSE's "*fail[ure]* to monitor D'Alessio's and other floor [members'] compliance" with securities law and regulations because such conduct "plainly falls within the scope of the quasi-governmental duties delegated to the NYSE." 258 F.3d at 106 (emphasis added). While this discussion in *D'Alessio* was cursory, as the case focused on other allegations of the NYSE's misconduct, we are not persuaded that absolute immunity should protect an SRO that decides to act but not one that decides not to act. The power to exercise regulatory authority necessarily includes the power to take no affirmative action. After all, the purpose of immunity is to give governmental officials—or those acting with the express delegation of the government, as with SROs—breathing room to exercise their powers without fear that their discretionary decisions may engender endless litigation. *Barbara*, 99 F.3d at 59 (stating that "allowing suits against the Exchange arising out of the Exchange's [quasi-governmental] functions would clearly 'stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress'" in enacting the Exchange Act) (second alteration in original). It makes little logical sense to cabin that needed breathing room by according immunity only to the decision to act. While absolute immunity by its very nature necessarily gives rise to a risk that reprehensible conduct—whether active or passive—will go unpunished, that

risk is accepted so that SROs will not be excessively timid in their regulatory decisions, including in their decisions not to act. Thus, we conclude that extending absolute immunity only to affirmative acts is neither warranted by our caselaw nor consonant with the purposes of absolute immunity.

Our understanding of immunity is further buttressed by this Circuit's prior decisions in other absolute immunity contexts where, for instance, a prosecutor, protected by absolute immunity in the decision to prosecute an individual, was similarly found immune for the decision not to prosecute. *Schloss v. Bouse*, 876 F.2d 287, 290 (2d Cir. 1989) ("[A]s a matter of logic, absolute immunity must also protect the prosecutor from damages suits based on his decision *not* to prosecute."); *see also Mangiafico v. Blumenthal*, 471 F.3d 391, 396 (2d Cir. 2006) ("[W]e can divine no meaningful difference between the Attorney General's decision in this case not to defend a state employee and the decisions of prosecutors and government attorneys to initiate (or not to initiate) civil or administrative proceedings."); *accord Harrington v. Almy*, 977 F.2d 37, 40 (1st Cir. 1992) (holding that immunity applies to "this action-or more accurately [this] refusal to act"). Accordingly, to the extent that this concept was unclear in our prior precedent, we make the assertion plain: If an SRO's exercise of a governmental power delegated to it deserves absolute immunity, the SRO's nonexercise of that power also entitles it to immunity.

In their second argument, Lead Plaintiffs, relying on *D'Alessio*, 258 F.3d at 106, assert that an SRO receives absolute immunity only "when acting in its capacity as a[n] SRO" and only to the extent that it "engages in conduct consistent with" its regulatory

powers (*i.e.*, no absolute immunity when an SRO acts inconsistently with the regulatory goals of the SEC). This position certainly has superficial appeal, but when scrutinized, its flaws become evident. First, we cannot square our holdings in *D'Alessio*, *Barbara*, or *DL Capital*, with Lead Plaintiffs' assertion here. In all three cases, the alleged misconduct of the SRO stock exchanges involved acts or determinations that could easily be characterized as inconsistent with the powers or functions delegated to them or beyond their capacities as SROs because the organizations had violated the very rules they were supposed to enforce. *See D'Alessio*, 258 F.3d at 98 (plaintiff alleged that the NYSE provided government investigators with "false, misleading and inaccurate information" about him and that the NYSE had failed to disclose to the SEC that it had "approved and encouraged" the practice for which plaintiff was charged) (internal quotation marks omitted); *Barbara*, 99 F.3d at 52 (plaintiff claimed that the NYSE wrongfully barred him from the exchange floor, causing him to leave the securities business); *DL Capital*, 409 F.3d at 96 (plaintiff alleged that the NASDAQ had committed fraud by "failing to disclose" its decision to cancel trading on a particular stock in a timely manner). It is clear that the claim in each case was that the defendant SRO abused its regulatory power. Analyzing these entities under our functional approach, however, we determined in each case that the SROs were entitled to absolute immunity because they were acting within the scope of the powers granted to them. Lead Plaintiffs attempt to distinguish these cases as involving only the positive use of governmental power, but, as discussed above, this is simply not the holding of *D'Alessio* or the other immunity cases like *Schloss* in

which this Court has repeatedly held that the nonexercise of a governmental power is entitled to the same immunity as an exercise of that power. There is accordingly no way to give coherence to our caselaw without rejecting this part of Lead Plaintiffs' argument.

Second and more importantly, the central question our SRO-immunity cases ask is not whether the SRO is acting (or not acting) "consistent with" the laws it is supposed to apply but rather whether the plaintiff's allegations concern the exercise of powers within the bounds of the government functions delegated to it. Under our precedent, the immunity protects the power to regulate, not the mandate to perform regulatory functions in a certain manner. Thus, the immunity depends only on *whether* specific acts and forbearances were incident to the exercise of regulatory power, and not on the propriety of those actions or inactions. Indeed, if "consistent with" and "capacity" meant that immunity only attaches to those who follow the law, the immunity doctrine would be effectively subverted. After all, individuals characteristically do not bring suit alleging an SRO is obeying its statutory and legal obligations; they bring suit alleging an SRO is violating the law or acting inconsistently with its legal obligations. Lead Plaintiffs here are accordingly asking us to carve out an exception that would all but swallow the doctrine whole, and this we decline to do.[3]

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[3] We also observe that Lead Plaintiffs' complaint is rife with language suggesting that absolute immunity is inappropriate where an SRO has either recklessly permitted or knowingly fostered wrongdoing and fraud. *See, e.g.*, Consolidated Compl. P P 188-91 (noting the Exchange's "proven track record of failing to adequately monitor and maintain surveillance and enforce compliance of its member firms' operations"

In sum, the proper way to read *D'Alessio*'s use of the terms "consistent with" and "capacity" is to focus on the specific function at issue in the allegations of misconduct to determine whether the conduct is "consistent with" the exercise of power delegated to the SRO and for which this Court has accorded absolute immunity. If such conduct was within the ambit of the SRO's delegated power, immunity presumptively attaches, even where the SRO wrongly exercises that power.

A. Application

Given this understanding of our caselaw, it is clear that the misconduct alleged by Lead Plaintiffs readily falls within the ambit of the quasi-governmental functions the SEC has delegated to the NYSE. Indeed, of the five categories of misconduct that Lead Plaintiffs allege in their complaint (interpositioning, trading ahead, freezing the book, manipulating the tick, and concealing evidence of wrongdoing), the first

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because "the NYSE as well as its top executives had a direct financial interest in the successful continuation of that scheme"). This would, however, undermine the immunity doctrine we apply today because it threatens to import a "bad faith" or "bad motive" element to absolute immunity, which is incompatible with the doctrine's purpose. *Shmueli*, 424 F.3d at 237 (absolute immunity "is such that it accords protection from . . . any judicial scrutiny of the motive for and reasonableness of official action") (internal quotation marks omitted); *Bernard*, 356 F.3d at 503 (absolute immunity applies even where the challenged conduct was motivated by a wrongful motive as such intent is irrelevant). Indeed, as the Ninth Circuit has cogently observed, "[t]he results of any immunity rule may be harsh," but Congress nevertheless saw fit to delegate to SROs certain regulatory powers for which they "enjoy freedom from civil liability when they act[] in their regulatory capacity," even where the SROs "act[] in a capricious, even tartuffian manner which cause[s] . . . enormous damage." *Sparta Surgical Corp. v. Nat'l Ass'n of Secs. Dealers, Inc.*, 159 F.3d 1209, 1215 (9th Cir. 1998).

four involve what Lead Plaintiffs themselves characterize as the failure or abandonment of the Exchange's regulatory duties. For example, Lead Plaintiffs complain that the NYSE-either with intent, knowledge or reckless disregard-permitted the Specialist Firms (1) to engage in interpositioning in violation of the Exchange's own regulations and (2) to trade ahead and front-run stocks to their tremendous financial advantage in violation of the securities laws and regulations. Lead Plaintiffs also claim that the NYSE turned a blind eye to the manipulation of the tick price of the stock and that the practice of freezing the book was a point of contention between the SEC and the Exchange in terms of the length of time that a Specialist Firm could engage in such activity. It is clear that these claims all involve the NYSE's action or inaction with respect to trading on the Exchange, which is indisputably within the NYSE's regulatory powers. Moreover, Lead Plaintiffs' own characterizations of the above claims implicitly concede that the NYSE was acting within the realm of the oversight powers delegated to it by the SEC. *See, e.g.*, Consolidated Compl. P 5 (alleging NYSE's "deliberate failure to properly oversee, regulate or supervise its securities exchange" and that the "NYSE deliberately failed to halt, expose or discipline the illegal trading practices [of member firms] to the extent necessary to deter, stop or prevent them"). This is a tacit concession that the NYSE's decisions to act (or not to act) with respect to the Specialist Firms' conduct is "consistent with" the powers delegated to it by the SEC.[4] Because these claims all relate to the

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[4] Moreover, throughout the complaint, Lead Plaintiffs allege that NYSE violated its own internal rules in permitting, for instance, trading ahead, *see* Consolidated Compl. P 87 (noting that NYSE Rules 105 and

"proper functioning of the regulatory system," *D'Alessio*, 258 F.3d at 106 (internal quotation marks omitted), the district court did not err when it granted immunity to the NYSE for its action or inaction with respect to these claims.

We confront a somewhat thornier question in evaluating the allegations that the NYSE knowingly permitted, or even actively encouraged, the Specialist Firms to submit doctored or altered regulatory reports to the NYSE and that it alerted the Specialist Firms to impending internal NYSE investigations so that the Firms could conceal evidence of wrongdoing. Lead Plaintiffs' allegations here focus on the NYSE's approach to weekly Form 81 Reports ("Form 81"), which every Specialist Firm was required to submit when it engaged in principal trades. The NYSE floor officials, Lead Plaintiffs claim, permitted their names and badge numbers to be used in preparing false Form 81s, essentially vouching for trades that they knew to be improper or wrong and even when the NYSE discovered a possible falsification, it would

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476 prohibit this type of conduct), or acting as principal when it was not necessary for the maintenance of a fair and orderly market, *id.* PP 71-74. They appear then to admit that the action (or inaction) complained of involves the NYSE's regulatory powers, and our own review of the NYSE's internal rules leads to the inexorable conclusion that the Exchange's enforcement (or nonenforcement) of these rules clearly implicates the quasi-governmental functions the SEC has delegated to the NYSE. *See, e.g.*, NYSE Rule 104(a) (prohibiting a Specialist Firm from trading for its own account unless reasonably necessary to maintain a fair and orderly market); NYSE Rule 92(a) (prohibiting any member or member organization of the NYSE to trade on its proprietary account if it has knowledge of "any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price"); NYSE Rule 401(a) (requiring members and member organizations to "adhere to the principles of good business practice in the conduct of his or its business affairs").

send the relevant Form 81 back to the Firm and permit the Form 81 to be resubmitted with the "correct" information. Officials at the Exchange also allegedly "tipped off" at least one of the Specialist Firms about an imminent investigation before the official announcement, permitting it, now forewarned, to alter its records to conceal its misconduct. At first glance, none of these actions appears to fall within the ambit of the powers delegated to the Exchange. The gravamen of the Lead Plaintiffs' claims, however, centers on the functions performed by NYSE in its supervisory and regulatory role: announcing investigations, signing off on regulatory reports on the stock exchange floor, and examining the Form 81s for content and legality. While these actions may not appear to form the heart of the regulatory functions delegated to the NYSE as an SRO, they are nonetheless central to effectuating the NYSE's regulatory decisionmaking. Indeed, in *DL Capital Group*, this Court noted that without the capacity to perform certain acts related to its core regulatory functions, an SRO "would be stripped of . . . critical and necessary part[s] of [its] regulatory powers." 409 F.3d at 98 (internal quotations omitted). Examining and approving Form 81s and other regulatory paperwork are critical and necessary to the NYSE's fulfillment of its regulatory role and oversight duties and the district court correctly granted immunity to the Exchange on this point. Similarly, the timing and method of the announcement of an official investigation is entitled to absolute immunity. Because "investigative actions taken by agency officials prior to the issuance of the formal order [announcing an official investigation] are within the scope of [the SEC agents'] duties," *Sprecher v. Graber*, 716 F.2d 968, 975 (2d Cir. 1983),

the NYSE, "stand[ing] in the shoes of the SEC . . . in monitoring compliance" with the securities laws, enjoys the same immunity as the SEC when "performing functions delegated to it under the SEC's broad oversight authority," *D'Alessio*, 258 F.3d at 105. It is thus clear that these allegations concern regulatory functions for which the NYSE is entitled to absolute immunity.

B. The Fraud Exception

Lead Plaintiffs also argue that the wide-ranging misconduct and fraud allegedly permitted or undertaken here by the NYSE should qualify as an exception to the absolute immunity bar. They cite our decision in *DL Capital Group* where we stated that

> precedent, not to mention common sense, strongly militates against carving out a "fraud" exception to SRO immunity. As to precedent, this Court has already implicitly held that SROs are absolutely immune to suits alleging fraud. In *D'Alessio*, after all, we upheld the dismissal of all the plaintiffs' claims even though one of the claims was for "fraudulent deceit and concealment." . . . Not only that, but this Court has, in other contexts, made clear that allegations of bad faith, malice, and even fraud-all of which may be relevant to a *qualified* immunity analysis-cannot, except in the most unusual of circumstances, overcome *absolute* immunity.

409 F.3d at 98 (citations and footnote omitted). Lead Plaintiffs contend that this case presents the "most unusual of circumstances," thus entitling them to overcome whatever grant of absolute immunity this Court might otherwise accord. While we agree that

the abuse of trust fraud purportedly engaged in by the Specialist Firms and the Exchange over the years-long Class Period appears egregious, we still conclude that a fraud exception should not apply here-even a one-time, "most unusual circumstances" exception. Indeed, courts have applied the absolute immunity doctrine without carving out a fraud exception even in cases alleging fraud in situations that directly implicate constitutionally protected personal liberty interests in the criminal context, including a case where a prosecutor allegedly committed fraud upon the courts in a criminal prosecution for capital murder, *Imbler*, 424 U.S. at 416 (alleged prosecutorial misconduct included knowingly permitting false testimony at trial and submitting altered evidence to the jury), or where allegedly unconstitutional restrictions were placed on a grand juror attempting to investigate official misconduct, *Fields v. Soloff*, 920 F.2d 1114, 1119 (2d Cir. 1990). If a fraud exception is not warranted in those situations where an individual's very liberty may be at stake, we conclude such an exception is also not appropriate here. Moreover, while Lead Plaintiffs characterize this case as representing the "most unusual of circumstances," an exception here may open a Pandora's box that would undermine the entire purpose behind the immunity doctrine. *See DL Capital Group*, 409 F.3d at 99 ("Thus, rejecting a fraud exception is a matter not simply of logic but of intense practicality since [otherwise] the [SRO's] exercise of its quasi-governmental functions would be unduly hampered by disruptive and recriminatory lawsuits.") (internal quotation marks omitted).

Lastly, we have cautioned before that courts confronted with claims of absolute immunity should consider "whether there exist alternatives to damage

suits against the official as a means of redressing wrongful conduct" if absolute immunity applies. *Barrett*, 798 F.2d at 571 (citing *Mitchell v. Forsyth*, 472 U.S. 511, 521-23, 105 S. Ct. 2806, 86 L. Ed. 2d 411 (1985)). The alternatives here are manifold. The SEC, after all, retains formidable oversight power to supervise, investigate, and discipline the NYSE for any possible wrongdoing or regulatory missteps. *See, e.g.*, *DL Capital Group*, 409 F.3d at 95 ("[I]f an SRO has violated, or is unable to comply with, *inter alia*, the provisions of the Exchange Act, its own rules, or the rules of the SEC, the SEC is authorized to suspend or even revoke an SRO's registration, as well as to impose lesser sanctions.") (citing 15 U.S.C. § 78s(g)). As the facts here pellucidly illustrate, the SEC did intervene and investigate the Exchange and the Specialist Firms and extracted from them considerable settlements, which not only garnered widespread public attention but included significant monetary penalties and implemented new methods of market regulation and oversight.

For all of the reasons stated above, we conclude the NYSE is entitled to absolute immunity and affirm the district court's determination on this issue.

II. Lead Plaintiffs' Standing to Sue for the NYSE's Alleged Misrepresentations

The district court concluded that Lead Plaintiffs lacked statutory standing to pursue their misrepresentation claims against the NYSE. However, the district court's reasons for dismissing the Lead Plaintiffs' claims were flawed. Citing our opinion in *Ontario Public Service Employees Union Pension Trust Fund v. Nortel Networks Corp.*, 369 F.3d 27 (2d Cir. 2004), the district court ruled that no liability can exist under Rule 10b-5 for "statements

by a non-issuer [of the security that is the subject of the suit] about a non-issuer." *In re NYSE Specialists*, 405 F. Supp. 2d at 305. We recognize that *Nortel Networks* contains language that could be read to suggest that a purchaser of a security may bring a fraud action under Rule 10b-5 only against the issuer of the security purchased. *See, e.g.*, 369 F.3d at 28 (suggesting that an individual lacks standing to sue a company "for making a material misstatement when the individual purchased the security of a company other than the one that made the misstatement"); *id.* at 34 ("Stockholders do not have standing to sue under *Section 10(b)* and *Rule 10b-5* when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they do not purchase."). Such a reading, however, would place beyond the reach of Rule 10b-5 false statements made by underwriters, brokers, bankers, and non-issuer sellers.

That is not what *Nortel Networks* held. In *Nortel Networks*, the plaintiffs had purchased stock in JDS Uniphase. Plaintiffs claimed that a different company, Nortel Networks, knowingly made falsely optimistic public statements about its own financial prospects. On the basis of a business relationship between JDS Uniphase and Nortel Networks, the plaintiffs claimed that their purchase price for JDS Uniphase stock had been inflated by Nortel Networks' false statements about itself. In the particular circumstances of the case, the connection between Nortel Networks' false statements about itself and the plaintiff's purchase of JDS Uniphase stock was too remote to sustain an action under Rule 10b-5.

In short, the district court incorrectly read *Nortel Networks* to mean that an action under Rule 10b-5 for false statements about a security purchased by the plaintiff lies only against the issuer of the security, or that only statements about a security issuer are actionable. Accordingly, we vacate the district court's decision with respect to statutory standing.

We express no opinion on the other grounds for dismissal that the NYSE raised below because we lack proper briefing on those issues. On remand, however, the district court is free to entertain such arguments. Specifically, we point the parties' and the district court's attention to the arguments regarding whether the NYSE enjoys SRO immunity for its alleged misrepresentations. *See, e.g., Weissman v. Nat'l Ass'n of Sec. Dealers, Inc.*, 468 F.3d 1306 (11th Cir. 2006), *reh'g en banc granted*, 481 F.3d 1295 (11th Cir. 2007). *But see DL Capital Group*, 409 F.3d 93; *Weissman*, 468 F.3d at 1313 (Tjoflat, J., dissenting). Likewise, the district court may consider whether Lead Plaintiffs have pled that reliance on the alleged misrepresentations caused their loss. Without a clear understanding as to what Lead Plaintiffs' theory of reliance is—whether they are asserting direct reliance on the alleged misrepresentations or are asking the Court to presume reliance based on a doctrine such as the fraud-on-the-market theory—we think it is inappropriate at this time for us to decide whether those pleadings are adequate to state a claim. We note, however, that Lead Plaintiffs' Rule 10b-5 claims do not appear to be of the nature where the fraud-on-the-market theory would apply, where the misrepresentation itself affects the market price of the security purchased. *See Basic Inc. v. Levinson*,

485 U.S. 224, 241-42, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988).

CONCLUSION

For the foregoing reasons, we affirm the judgment of the district court in part, vacate the judgment in part and remand for proceedings consistent with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

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03 Civ. 8264 (RWS)

In re NYSE SPECIALISTS SEC. LITIG.

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405 F. Supp. 2d 281

December 12, 2005, Decided
December 13, 2005, Filed

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Attorneys for Defendants: FRIED, FRANK, HARRIS, SHRIVER & JACOBSON, Attorneys for New York Stock Exchange, New York, NY, By: DEBRA M. TORRES, ESQ., Of Counsel; MORGAN, LEWIS & BOCKIUS, Attorneys for Bear Wagner Specialists and Bear Stearns & Co., New York, NY, By: ROBERT M. ROMANO, ESQ., JOHN M. VASSOS,

ESQ., Of Counsel; DAVIS POLK & WARDWELL, Attorneys for FleetBoston Financial Corp.; Fleet Specialist, Inc.; Bank of America Corp. and Quick & Reilly, Inc., New York, NY, By: LAWRENCE PORTNOY, ESQ., Of Counsel; WEIL, GOTSHAL & MANGES, Attorneys for LaBranche & Co., Inc. and LaBranche & Co. LLC, New York, NY, By: IRWIN H. WARREN, ESQ., STEPHEN A. RADIN, ESQ., Of Counsel; KATTEN MUCHIN ZAVIS ROSENMAN, Attorneys for George M. L. LaBranche, IV, New York, NY, By: E. MICHAEL BRADLEY, ESQ., Of Counsel; DICKSTEIN SHAPIRO MORIN & OSHINSKY, Attorneys for Performance Specialist Group LLC, Washington, DC, and New York, NY, By: HOWARD SCHIFFMAN, ESQ., ALEXANDER D. WIDELL, ESQ., Of Counsel; WILMER CUTLER PICKERING HALE AND DORR, Attorneys for Spear, Leeds & Kellogg Specialists LLC; Spear, Leeds & Kellogg, LP., Goldman, Sachs & Co., and The Goldman Sachs Group, Inc., New York, NY, By: ROBERT B. McCAW, ESQ., ROBERT W. TRENCHARD, ESQ., Of Counsel; KING & SPALDING, Attorneys for SIG Specialists, Inc.; Susquehanna International Group, LLP, and Susquehanna Financial Group, LLP, New York, NY, By: RICHARD A. CIRILLO, ESQ., PAUL A. STRAUS, ESQ., Of Counsel; WOLF, BLOCK, SCHORR & SOLIS-COHEN, Attorneys for SIG Specialists, Inc. and Susquehanna International Group, LLP, Philadelphia, PA, By: M. NORMAN GOLDBERGER, ESQ., NATHAN E. KASE, ESQ., ANDREW C. CURLEY, ESQ., Of Counsel; SULLIVAN & CROMWELL, Attorneys for Van der Moolen Holding, NV, New York, NY, By: ROBERT J. GIUFFRA, JR., ESQ., STACEY R. FRIEDMAN, ESQ., Of Counsel; FRIEDMAN KAPLAN SEILER & ADELMAN, Attorneys for Van der Moolen Specialists

USA, LLC, New York, NY, By: KATHERINE L. PRINGLE, ESQ., ROBERT S. LOIGMAN, ESQ., MELISSA E. LONDON, ESQ., Of Counsel.

JUDGES: ROBERT W. SWEET, U.S.D.J.

OPINION

Sweet, D.J.

LaBranche & Co., LLC ("LaBranche LLC"), LaBranche & Co., Inc. ("LaBranche & Co."), George M.L. LeBranche, IV ("M. LaBranche"), Spear, Leeds & Kellogg Specialists LLC ("Spear Leeds LLC"), Spear, Leeds & Kellogg, LP ("Spear Leeds LP"), Goldman Sachs & Co., Inc. ("Goldman Sachs & Co."), The Goldman Sachs Group, Inc. (the "Goldman Sachs Group"), Van der Moolen Specialists USA, LLC ("VDM Specialists"), Van der Moolen Holding, NV ("VDM Holding"), Fleet Specialist, Inc. ("Fleet Specialist"), FleetBoston Financial Corp. ("FleetBoston Corp."), Bank of America Corp. ("Bank of America"), Quick & Reilly, Inc. ("Quick & Reilly"), Bear Wagner Specialists LLC ("Bear Wagner LLC"), Bear Stearns & Co., Inc. ("Bear Stearns & Co."), SIG Specialists, Inc. ("SIG Specialists"), Susquehanna International Group, LLP ("SIG LLP"), Susquehanna Financial Group, LLP (Susquehanna), and Performance Specialist Group, LLC ("Performance Specialist") (collectively, the "Specialist Defendants")[1]

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[1] There are three relevant subsets within the Specialist Defendants. First, LaBranche LLC, Spear Leeds LLC, VDM Specialists, Fleet Specialist, Bear Wagner LLC, SIG Specialists, and Performance Specialist are referred to collectively as the "Specialist Firms." Second, LaBranche & Co., Spear Leeds LP, Goldman Sachs & Co., the Goldman Sachs Group, VDM Holding, FleetBoston Corp., Bank of America, Quick & Reilly, Bear Stearns & Co., SIG LLP, and Susquehanna are referred to collectively as the "Affiliated Companies." Third, SIG Specialists, SIG

have moved pursuant to *Rules 12(b)(6)* and *9(b)*, Fed. R. Civ. P., to dismiss Plaintiffs' Consolidated Complaint ("the Complaint"). Defendant New York Stock Exchange ("NYSE")[2] has moved to dismiss the Complaint pursuant to *Rule 12(b)(6)*. Lead Plaintiffs California Public Employees' Retirement System ("CalPERS") and Empire Programs, Inc. ("Empire") (collectively, the "Plaintiffs") have moved to modify the discovery stay set forth in Section 21D(b)(3)(B) of the Securities Exchange Act of 1934, as amended by the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4(b)(3)(B).

For the reasons set forth below, the motions to dismiss of the Specialist Defendants are granted in part and denied in part. The motion of NYSE to dismiss is granted. To the extent that claims have not been dismissed with prejudice, leave is granted to replead within thirty (30) days of the entry of this opinion.

Prior Proceedings

On October 17, 2003, this action was initiated by Pirelli Armstrong Tire Corporation Retiree Medical Benefits Trust, which filed a complaint (03 Civ. 8521) on behalf of itself and all others similarly situated. On November 11, 2003, Empire filed its complaint (03 Civ. 8935). On December 16, 2003, CalPERS filed its complaint (03 Civ. 9968). On March 16, 2004, Rosenbaum Partners, LP filed a complaint (04 Civ. 2038) in its individual capacity. By Opinion dated May 27, 2004, the above-referenced actions were

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LLP, and Susquehanna are referred to collectively as the "SIG Defendants."

[2] NYSE and the Specialist Defendants are referred to collectively as the "Defendants."

consolidated for all purposes under docket number 03 Civ. 8264, CalPERS and Empire were appointed as lead plaintiffs, and lead counsel was selected. *See Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust v. LaBranche & Co.*, 229 F.R.D. 395, 2004 WL 1179311 (2004). A Consolidated Complaint (the "Complaint") was filed on September 17, 2004. On November 16, 2004, the Specialist Defendants moved to dismiss the Complaint pursuant to Rules 9(b) and 12(b)(6), Fed. R. Civ. P. On November 17, 2004, the NYSE moved to dismiss the Complaint pursuant to Rule 12(b)(6). Pursuant to a briefing schedule agreed to by the parties, these motions were heard and marked fully submitted on April 13, 2005.

A motion to modify the PSLRA discovery stay was filed by the Plaintiffs on October 1, 2004. This motion was heard and marked as fully submitted on November 17, 2004.

The Parties

CalPERS is the largest public employee retirement system in the United States, with assets of over $ 166 billion and nearly 1.4 million beneficiaries, including active and retired public employees. CalPERS is alleged to have purchased and/or sold almost three billion shares of NYSE-listed stock between October 17, 1998 and October 15, 2003 (the "Class Period").

Empire is a New Jersey corporation that has its principal place of business in Saddle River, New Jersey. Empire is alleged to have purchased and/or sold over four billion shares of NYSE-listed stock during the Class Period.

The NYSE is a not-for-profit corporation organized under the laws of New York State.[3] Pursuant to the Exchange Act, it is registered with the SEC as a national stock exchange. Each of the specialist firms and their individual employee specialists are members of the NYSE.

LaBranche LLC, is a registered broker-dealer with the SEC and an NYSE member organization. LaBranche LLC is the largest NYSE specialist firm, serving as a specialist for more than 600 companies listed on the NYSE. During the Class Period, LaBranche LLC accounted for about 29% of the annual trading volume on the NYSE. The parent company of LaBranche LLC is LaBranche & Co. M. LaBranche is the Chairman, President, and CEO of LaBranche & Co., and he has served as a LaBranche LLC specialist since 1977. During the Class Period, he served as a Special Governor of the NYSE, in which capacity he was charged with overseeing the trading activities of the specialist firms, and he was a member of the NYSE Market Performance Committee.

Spear Leeds LLC is an NYSE specialist firm and a registered broker-dealer. Spear Leads LLC is a subsidiary of parent company Spear Leads LP, which is a wholly owned subsidiary of the Goldman Sachs Group. Spear Leeds LLC is the second largest specialist firm on the NYSE, serving as a specialist for the stocks of more than 550 NYSE-listed

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[3] The NYSE recently voted to approve a merger with Archipelago Holdings, which will transform the NYSE from a not-or-profit entity to a publicly traded company next year. *See* Jenny Anderson, *Big Board-Archipelago Deal Approved by Wide Margin*, N.Y. Times, Dec. 7, 2005, at C3. However, at all times relevant to this complaint, the NYSE was a not-for-profit organization.

companies and accounting for about 20% of the annual trading on the NYSE during the Class Period. Spear Leeds LLC is affiliated with Goldman Sachs & Co., which is a member firm of the NYSE.

VDM Specialists is an NYSE specialist firm responsible for trading in the stocks of more than 370 public companies listed on the NYSE. During the Class Period, VDM Specialists accounted for about 12.5% of the annual trading volume on the NYSE. Van der Moolen Holding is the parent company of VDM Specialists.

Fleet Specialist is an NYSE specialist firm that is responsible for trading in more than 430 NYSE-listed companies. It accounted for some 18% percent of the NYSE's annual trading volume during the Class Period. Since April 1, 2004, the parent company of Fleet Specialist has been Bank of America. Prior to that time, Fleet Specialist' parent company was FleetBoston Corp., which merged with Bank of America. Quick & Reilly is a member of the NYSE and an affiliate of Fleet Specialist and Bank of America. Prior to its merger with Bank of America, FleetBoston Corp. was the parent of Quick & Reilly.

Bear Wagner LLC is a member of the NYSE and a registered broker-dealer that operates as an NYSE specialist. Bear Wagner LLC acts as specialist for more than 340 NYSE-listed stocks and accounted for some 16% of the NYSE's annual trading volume during the Class Period. Bear Stearns & Co. is a member of the NYSE and is the broker-dealer affiliate of Bear Wagner LLC.

SIG Specialists is a member of the NYSE and a wholly-owned subsidiary of SIG LLP. SIG Specialists is a registered broker-dealer that operates as an

NYSE specialist firm. SIG Specialists is responsible for trading in more than 150 NYSE-listed stocks and accounted for some 3% of the NYSE trading volume during the Class Period. Susquehanna, a member organization of the NYSE, is affiliated with SIG Specialists and SIG LLP.

Performance Specialist, a member of the NYSE, is a registered broker-dealer that operates as a NYSE specialist. Performance Specialist is responsible for the trading of more than 165 NYSE-listed stocks. During the Class Period, it accounted for some 1.5% of the NYSE's annual trading volume.

The Action

This is a securities class action brought on behalf of public investors who purchased and/or sold shares listed on the New York Stock Exchange ("NYSE") during the Class period, for which specialist firms were responsible for maintaining the trading market. The Consolidated Complaint (the "Complaint") alleges that Defendants violated the Securities Exchange Act of 1934 (the "Exchange Act") and violated the fiduciary duty owed to the class members, and/or aided and abetted the breach of such duty.

Count One of the Complaint asserts that all Defendants violated *Section 10(b)* of the Exchange Act and *Rule 10b-5* promulgated thereunder. Count Two asserts that all Defendants violated *Section 20(a)* of the Exchange Act. Count Three asserts that NYSE violated *Section 6(b)* of the Exchange Act. Count Four asserts that all Defendants breached the fiduciary duty owed to the Plaintiffs and/or aided and abetted the breach of such duty. Count Five asserts that Spear Leeds LP, Goldman Sachs & Co., Quick &

Reilly, Bear Stearns, and Susquehanna breached fiduciary duties owed to the Plaintiffs.

The Role Of The NYSE Specialist

The Complaint involves allegations that the specialist firms of the NYSE violated their legal duties to investors, thereby causing injury. In order to assess the sufficiency of these allegations, an understanding of the function and obligations of the specialist firms is necessary.

The purchase and sale of securities on the NYSE must be carried out by a specialist who works on the floor of the exchange.[4] Each security listed for trading on the NYSE is assigned to a particular specialist. To execute purchases and sales of a particular security, buyers and sellers must present their bids to buy, and offers to sell, to the specialist assigned to the security. These orders could be brought to a specialist in one of two ways. First, the order could be conveyed orally and in person to the specialist by a floor broker on the floor of the exchange. Second, an order could be transmitted to the specialist electronically using the NYSE's Super Designated Order Turnaround System ("Super DOT"). Orders transmitted over the Super DOT system would appear on a special computer screen often referred to as the "display book."[5] Each

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[4] The description that follows of the role of specialists largely reflects the allegations contained in the April 2005 indictments referred to below. *See* 05 Cr. 390-398.

[5] The SEC Order explained that "the Display Book is an electronic workstation provided by the NYSE . . . . The Display Book allows specialists to . . . receive and process orders, disseminate trade and quote information, report trade executions, research order and execution status,

specialist has a computerized "display book" screen at his or her trading post.

After receipt of an order, a specialist could execute the order in two different manners. Generally, orders were executed in the "agency" or "broker" manner, in which the specialist was required to match any open orders to buy from one investor with an open order to sell from another investor within the same price range. Specialists generally received no compensation for filling orders on an agency basis.

Second, specialists were permitted to execute, in certain limited circumstances, trades on a "principal" or "dealer" basis, when required to do so to maintain a fair and orderly market. In such circumstances, such as if there were no matching orders to sell and orders to buy, the specialist was permitted to execute an investor's order to buy stock by selling the stock from the specialist's proprietary account, or "inventory" of stock, to the investor. Additionally, the specialist was permitted to execute an investor's order to sell stock by buying that stock and holding the stock in the investor's inventory.

A respected treatise provides the following description of the duties performed by the NYSE specialist:

> The specialist firm occupies a unique dual role in the operation of the New York Stock Exchange, which is also the case with the other securities exchanges. First, a specialist firm acts as a "broker's broker," maintaining a "book" on which other brokers can leave customers' "limit

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manage positions and view profit and loss in the dealer account." (SEC Order, 2004 WL 626573, at *12 n.3.)

orders" (i.e., orders to buy or sell at a price at which they cannot currently be executed). Second, a specialist acts as the exclusive franchised dealer, or "market maker" in its assigned stocks, buying and selling shares from other brokers when there are no customer orders on its book against which they can be matched.

The functions of the specialist can be illustrated by the following example. A firm is the specialist in an actively-traded stock, in which the market is $ 40 to $ 40.10. This means that customer orders are on the specialist's book to buy specified numbers of shares at $ 40 or less, and other orders are on his book to sell at $ 40.10 or more (for historical reasons, shares formerly were quoted in halves, quarters and eighths, rather than cents but now are traded in decimals). A broker who comes to the specialist with an order to sell "at the market" will sell to the customer with the first buy order on the book at $ 40, and a broker who comes with a market order to buy will buy from the customer with the first sell order on the book at $ 40.10. The specialist acts solely as a subagent, receiving a portion of the "book" customer's commission to his broker.

Now assume the same firm is also the specialist in an inactively traded stock. The only orders on the book are an order to buy at $ 38 and an order to sell at $ 42. If the specialist acted solely as agent, a broker who came in with a market order to sell would receive $ 38, and another broker who came in an hour later with a market order to buy would pay $ 42. The report of these two trades on the "tape" would indicate the stock had risen 4 points, or 10%, in an hour. The exchange

therefore imposes an obligation on the specialist to maintain an "orderly market" in his assigned stocks, buying and selling for his own account to even out swings which would result from buyers and sellers not appearing at his post at the same time. In this case he might make his market at $ 40 to $ 40.25, trading for his own account as long as necessary, but yielding priority to customers' orders on his book whenever they provide as good a price to the party on the other side.

In essence, exchange trading and the specialist system is based on a "continuous two-way agency auction market" in which the firms acting as specialists "are responsible for the quality of the markets" for the securities in which they specialize. The specialist's obligation is also phrased in terms of the duty to maintain a fair and orderly market. The SEC has explained that a fair and orderly market is one that is not marred by manipulation or deception and characterized by reliable price continuity.

Specialists on an exchange are viewed as having two primary duties: to secure the best execution of orders with "minimal dealer intervention" and at the same time to manage supply and demand imbalances. Specialists carry out these obligations by participating in the market both as a broker or agent in acting as an intermediary between two matching orders and also as a dealer or principal when there is no available counter party to the transaction. Thus, specialists should not interposition themselves between matching offsetting orders. In other words, specialists may obtain the best execution by matching transactions and crossing customer orders. In

> fact, it is the specialist's obligation to do so if possible.

4 Thomas Lee Hazen, *Law of Securities Regulation* § 14.11[1][C] (5th ed. 2005).

NYSE Rules Governing the Conduct of Specialists

NYSE Rule 104 places a negative obligation on specialists by prohibiting a specialist from trading for his own account unless it is reasonably necessary to maintain a fair and orderly market. Rule 104 states in relevant part: "No specialist shall effect . . . purchases or sales of any security in which such specialist is registered . . . unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."

NYSE Rule 92, as amended, provides that "no member or member organization shall cause the entry of an order to buy (sell) any Exchange-listed security for any account in which such member or member organization . . . is directly or indirectly interested (a 'proprietary order'), if the person responsible for the entry of such order has knowledge of any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price." Rule 92 also applies to the specialist buying or selling a security while holding an unexecuted customer market buy or sell order, as well as to circumstances where the specialist holds unexecuted customer limit orders at a price that could be satisfied by the proprietary transaction effected by the specialist.

NYSE Rule 123B (Exchange Automated Order Routing Systems) requires specialists to cross orders

received over the DOT system. Rule 123B(d) states in relevant part: "a specialist shall execute System orders in accordance with the Exchange auction market rules and procedures, including requirements to expose orders to buying and selling interest in the trading crowd and to cross orders before buying or selling from his own account."

NYSE Rule 401 requires NYSE member organizations to "adhere to the principles of good business practice in the conduct of his or its business affairs." Similarly, NYSE Rule 476(a)(6) provides sanctions if NYSE member organizations engage in conduct "inconsistent with just and equitable principles of trade." Pursuant to NYSE Rule 476(a)(7), member organizations must also refrain from engaging in "acts detrimental to the interest or welfare of the Exchange."

NYSE Rule 342 provides that "each office, department or business activity of a member or member organization . . . shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility."

The Allegations

The following facts are drawn from the Complaint and do not constitute findings of the Court.

Seven specialist firms—LaBranche LLC, Spear Leeds LLC, Van der Moolen Specialist, Fleet Specialist, Bear Wagner LLC, SIG Specialists, and Performance Specialist—handle the trading in stocks for all of the NYSE's more than 2,800 listed companies. The approximate share of the NYSE annual trading volume handled by each of these defendants during the Class Period is as follows:

Firm	% NYSE Annual Volume
LaBranche LLC	29%
Spear Leeds LLC	20%
VDM Specialists	12.5%
Fleet Specialist	18%
Bear Wagner LLC	16%
SIG Specialists	3%
Performance Specialist	1.5%

The stock of each of the approximately 2,800 companies listed on the NYSE is assigned by the NYSE to one of these seven specialist firms. Only one specialist can be designated for a given stock listed on the NYSE, although a given specialist firm may handle more than one stock.

It is alleged that the Specialist Defendants engaged generally in the following illegal practices: (1) interpositioning (*see* Compl. PP76-82 (defining interpositioning as "taking advantage of the spread between the bid and offer prices by buying stock from one public investor, and then selling it to another, locking in a guaranteed, riskless profit")); (2) trading ahead (*see id.* PP83-90 (defining trading ahead as filling public orders from a specialist's own firm accounts ahead of orders received from customers)); (3) freezing the book (*see id.* PP91-104 (defining

freezing the book as improperly facilitating proprietary trading by freezing the NYSE Display Book and thereby halting customer interaction and trading)); (4) manipulating the tick (*see id.* PP105-09 (defining manipulating the tick as asking or signaling a member in the crowd to purchase part of a public offer so that the specialist could then, under NYSE rules, engage in proprietary trading)); and (5) falsifying trade reports (*see id.* PP110-26 (describing how certain specialist firms falsified NYSE-mandated weekly reports concerning proprietary trading)).

A. ***The SEC/NYSE Investigation***

On March 30, 2004, the Securities and Exchange Commission ("the SEC") announced that: (1) pursuant to Section 15(b)(4) and *21C* of the Exchange Act, it had instituted administrative and cease-and-desist proceedings against LaBranche LLC, Spear Leeds LLC, VDM Specialists, Fleet Specialist, Bear Wagner LLC, SIG Specialists, and Performance Specialist; and (2) these seven firms had all settled the SEC and NYSE investigations. Pursuant to this settlement, the specialist firms agreed to pay more than $ 240 million in penalties and disgorgement. The allegations with respect to each of the Specialist Defendants are summarized below.

1. ***LaBranche LLC***

The SEC and NYSE determined that between January 1999 and 2003, LaBranche LLC engaged in interpositioning, trading ahead, and non-execution of limit orders. Such practices resulted in customer disadvantage of $ 41,646,440. Of this total, $ 8,689,574 of customer disadvantage was the result of interpositioning, $ 30,969,236 was the result of trading

ahead, and $ 1,987,630 was the result of non-execution of limit orders.

The SEC and NYSE determined that some 41% of LaBranche LLC's customer disadvantage from interpositioning occurred in just six stocks—Nokia, Lucent Technologies Inc., Morgan Stanley, Tyco International Ltd., Compaq Computer Corp., and Merck & Co. Inc. Furthermore, it was determined that the interpositioning violations with respect to certain transactions in these stocks were done by certain LaBranche LLC specialists with scienter.

The SEC and NYSE determined that certain senior executives at LaBranche LLC knew about the illicit trading because certain of the LaBranche LLC specialists who were engaged in such interpositioning in these six stocks were senior executives at LaBranche LLC, including managing directors, post managers, and a floor captain, some of whom had supervisory responsibility for LaBranche LLC's trading activities on the NYSE floor.

The SEC and NYSE observed that between January 2000 and July 2003, the NYSE issued five separate fines to LaBranche LLC or certain of its specialists for instances of trading ahead. Furthermore, the NYSE issued an 2001 examination report to LaBranche LLC that noted a "multitude" of instances in which a LaBranche LLC specialist had traded ahead of customer orders. In February 2003, the NYSE issued LaBranche LLC an admonition letter for excessive freezing of the Display Book in late 2002.

Based on these determinations (which were neither admitted nor denied), LaBranche LLC agreed to pay

$ 41,646,440 in disgorgement and $ 21,872,320 in civil penalties.

2. ***Spear Leeds LLC***

The SEC and NYSE determined that from January 1999 through 2003, Spear Leeds LLC engaged in interpositioning, trading ahead and intentional non-execution of limit orders and that such practices resulted in customer disadvantage of $ 28,776,072. Of this total, $ 8,309,962 of customer disadvantage was the result of interpositioning, $19,430,004 was the result of trading ahead, and $ 1,036,106 was the result of non-execution of limit orders.

The SEC and NYSE determined that some 76% of Spear Leeds LLC's customer disadvantage from interpositioning occurred in just six stocks—AOL Time Warner, International Business Machines Corporation, Micron Technology, Inc., American International Group, Inc., Teradyne, Inc., and Verizon Communications Inc. The interpositioning violations with respect to certain transactions in these six stocks were done by certain Spear Leeds LLC specialists with scienter.

The SEC and NYSE determined that certain Spear Leeds LLC senior executives knew about the illicit trading because certain of the specialists who were engaged in some of the most egregious cases of improper conduct were among the most senior executives at Spear Leeds LLC, including managing directors and team captains.

In June 2002, the NYSE issued a $ 1,000 fine to a Spear Leeds LLC predecessor because five of its specialists had specialists traded ahead.

The SEC and NYSE determined that between 1999 and 2003, trading ahead of unexecuted limit orders by Spear Leeds LLC caused $ 1,036,106 in customer disadvantage.

Based on these determinations (which were neither admitted nor denied), Spear Leeds LLC paid $ 28,776,072 in disgorgement and $ 16,496,406 in civil penalties.

3. ***VDM Specialists***

The SEC and NYSE determined that from January 1999 through 2003, VDM Specialists engaged in interpositioning, trading ahead, and intentional non-execution of limit orders and that such conduct resulted in $ 34,926,613 of customer disadvantage. Of this total, $ 14,629,743 of customer disadvantage was caused by interpositioning, $ 19,209,087 was the result of trading ahead, and $ 1,087,783 was the result of non-execution of limit orders.

The SEC and NYSE determined that some 80% of VDM Specialists' customer disadvantage from interpositioning occurred in just six stocks—Nortel Networks Corporation, Pfizer Inc., Hewlett-Packard Company, Time Warner Inc., The Walt Disney Company, and Eli Lilly & Co. Interpositioning in Nortel Networks alone accounted for some 29% of this disadvantage. The SEC and NYSE determined that the interpositioning in these six stocks was done with scienter.

The SEC and NYSE determined that certain members of VDM Specialists' management committee

engaged in interpositioning in one or more of the six stocks listed above, and these members of the management committee had the supervisory responsibility for the firm's trading operations on the NYSE floor, including supervising a floor captain who himself engaged in such interpositioning in one or more of the six stocks.

The NYSE and SEC observed that in 2001, the NYSE had provided VDM Specialists with an examination report showing that the firm had traded ahead and disadvantaged customer orders. In 2002, the NYSE provided VDM Specialists with an examination report that identified additional instances of trading ahead. Senior management at VDMS received these reports and reviewed them with NYSE staff.

Based on these determinations (which were neither admitted nor denied), VDM Specialists agreed to pay $ 34,926,613 in disgorgement and $ 22,748,491 in civil penalties.

4. ***Fleet Specialist***

The SEC and NYSE determined that from January 1999 through 2003, Fleet Specialist engaged in interpositioning, trading ahead and intentional non-execution of limit orders, and that such practices resulted in $ 38,013,594 of customer disadvantage. Of this total, $ 9,797,398 of customer disadvantage was caused by interpositioning, $ 26,969,830 was caused by trading ahead, and $ 1,246,366 was caused by non-execution of limit orders.

Some 80% of Fleet Specialist' customer disadvantage from interpositioning occurred in just six stocks—General Electric Company, Goldman Sachs Group Inc., Applera-Celera Genomics, JP Morgan

Chase & Co., Charles Schwab Corp., and Johnson & Johnson. General Electric Company alone accounted for more than 61% of this customer disadvantage. The SEC and NYSE determined that these interpositioning transactions were done with scienter.

The SEC and NYSE determined that in 2001 and 2002, senior managers at Fleet Specialist received internal reports of specific instances of improper conduct by certain specialists.

The SEC and NYSE observed that in February 2002, the NYSE had issued an admonition letter to Fleet Specialist noting that between October 2000 and April 2001, certain of its specialists had effected transactions for Fleet Specialist' dealer account while in possession of previously entered agency orders on the same side of the market, resulting in inferior price executions of such agency orders.

Based on these determinations (which were neither admitted nor denied), Fleet Specialist agreed to pay $ 38,013,594 in disgorgement and $ 21,083,875 in civil penalties.

5. ***Bear Wagner LLC***

The SEC and NYSE determined that from January 1999 through 2003, Bear Wagner LLC engaged in interpositioning, trading ahead, and intentional non-execution of limit orders and that such conduct resulted in $ 10,724,903 of customer disadvantage. Of this total, $ 2,074,303 of customer disadvantage was caused by interpositioning, $ 8,085,348 was caused by trading ahead, and $ 565,252 was caused by the non-execution of limit orders.

Some 68% of Bear Wagner LLC's customer disadvantage from interpositioning occurred in just six stocks—Texas Instruments Inc., Motorola Inc., Merrill Lynch & Co. Inc., Citigroup Inc., EMC Corp./Massachusetts, and Corning Inc. The SEC and NYSE determined that these interpositioning transactions were done with scienter.

The SEC and NYSE noted that a February 2002 examination by the NYSE identified several instances where a Bear Wagner LLC specialist appeared to have traded ahead of an executable customer order. A December 2002 examination by the NYSE identified 33 additional instances where Bear Wagner LLC specialists appeared to have traded ahead of executable customer orders.

Based on these determinations (which were neither admitted nor denied), Bear Wagner LLC agreed to pay $ 10,724,903 in disgorgement and $ 5,534,543 in civil penalties.

6. ***SIG Specialists***

The SEC and NYSE determined that from January 1999 through 2003, SIG Specialists engaged in interpositioning, trading ahead, and the non-execution of limit orders and that such conduct resulted in $ 2,045,571 of customer disadvantage. Of this total, $ 282,983 of customer disadvantage was caused by interpositioning, $ 1,684,525 was caused by trading ahead, and $ 78,063 was caused by the non-execution of limit orders.

Some 86% of SIG Specialists' customer disadvantage from interpositioning occurred in just six stocks—Analog Devices, Inc. ("ADI"), Solectron Corp., Ensco International Inc., Lexmark International, Inc., Calpine Corp., and L-3

Communications Holdings, Inc. ADI alone accounted for more than 32% of SSI's overall customer disadvantage from interpositioning. The SEC and NYSE determined that certain of these interpositioning transactions were done with scienter.

Based on these determinations (which were neither admitted nor denied), SIG Specialists agreed to pay $2,045,571 in disgorgement and $ 988,018 in civil penalties.

7. ***Performance Specialist***

The SEC and NYSE determined that from January 1999 through 2003, Performance Specialist engaged in interpositioning and trading ahead that resulted in $1,491,171 of customer disadvantage. Of this total, $140,488 of customer disadvantage was caused by interpositioning, $1,283,098 was caused by trading ahead, and $67,585 was caused by non-execution of limit orders.

Some 78% of Performance Specialist overall customer disadvantage from interpositioning occurred in just six stocks—Sony Corp. ("SNE"), Safeguard Scientifics, Inc., CBS Corp., Illinois Tool Works, Infinity Broadcasting Corp., and GTE Corp. SNE alone accounted for more than 34% of this customer disadvantage from interpositioning. The SEC and NYSE determined that these interpositioning transactions were done with scienter.

The SEC and NYSE noted that certain of the specialists who were engaged in such interpositioning in these six stocks were also senior executives with supervisory responsibilities for PSG's trading activities on the NYSE floor.

Based on these determinations (which were neither admitted nor denied), SIG Specialists agreed to pay $ 1,491,171 in disgorgement and $ 680,761 in civil penalties.

B. ***Allegations Contained In The April 2005 Indictments***

In April 2005, a grand jury in this district handed down criminal indictments against certain current and former individual specialists at the NYSE alleging violations of 15 U.S.C. §§ 78j(b) and 78ff and 17 C.F.R. § 240.10b-5. Since the information contained in these indictments can be judicially noticed by this Court, *see Ives Labs., Inc. v. Darby Drug Co.*, 638 F.2d 538, 544 n.8 (2d Cir. 1981), these materials will be considered in connection with this motion. *See Kramer v. Time Warner Inc.*, 937 F.2d 767, 773 (2d Cir. 1991).

1. ***LaBranche LLC (United States v. Deboer (05 Crim. 396))***

The above-referenced indictment alleges that from March 2000 through April 2003, LaBranche LLC specialist Freddy DeBoer ("DeBoer") caused 7,710 instances of interpositioning, which resulted in profits of $ 770,000. During this same period, DeBoer is alleged to have engaged in 11,620 instances of trading ahead, which resulted in $ 3,280,000 in customer harm. Such conduct is alleged to have included trades that involved shares of Nokia Corporation, Lehman Brothers Holdings, Inc., and Celestica Inc.

2. ***Spear Leeds LLC (United States v. Johnson (05 Crim. 392))***

The above-referenced indictment alleges that from October 2000 through April 2003, Spear Leeds specialist Robert A. Johnson, Jr. ("Johnson") caused over 6,390 instances of interpositioning, which resulted in illegal profits of $ 350,000. During this same period, Johnson is alleged to have engaged in 4,740 instances of trading ahead, which resulted in more than $380,000 in customer harm. Such conduct is alleged to have included trades that involved shares of Verizon Communications, Inc. and Bell Atlantic.

3. ***VDM Specialists (United States v. Bongiorno et al. (05 Crim. 390)***

The above-referenced indictment alleges that between January 1999 and April 2003, VDM specialists Joseph Bongiorno ("Bongiorno"), Patrick McGagh ("McGagh"), Michael Hayward ("Hayward"), Michael Stern ("Stern"), Richard Volpe ("Volpe"), Robert Scavone ("Scavone"), and Gerard Hayes ("Hayes") engaged in a scheme to trade ahead of customer orders and also to interposition proprietary trades between such orders. The specific allegations with respect to each of these VDM specialists are summarized below.

Specialist	Instances of Interpositioning And Improper Profits Derived	Instances of And Trading Ahead And Resulting Customer Harm	Specific Stocks Referenced
Bongiorno	15,620 instances ($ 1,380,000)	8,630 instances ($ 1,360,000)	Hewlett-Packard Company

Specialist	Instances of Interpositioning And Improper Profits Derived	Instances of And Trading Ahead And Resulting Customer Harm	Specific Stocks Referenced
McGagh	21,290 instances	4,200 instances	Nortel Networks
	($ 3,430,000)	($ 1,240,000)	Corp.; Pfizer Inc.
Hayward	5,210 instances	5,000 instances	Apache Corp.; SPX
	($ 690,000)	($ 1,190,000)	Corporation; Time
			Warner Inc.
Stern	3,980 instances	5,250 instances	Duke Energy Corp.;
	($ 400,000)	($ 630,000)	Kohls Corp.; Eli
			Lilly and Company
Volpe	13,730 instances	5,270 instances	The Walt Disney
	($ 790,000)	($ 600,000)	Company; Pfizer Inc.
Scavone	3,710 instances	4,540 instances	Eli Lilly and
	($ 197,000)	($ 330,000)	Company

Specialist	Instances of Interpositioning And Improper Profits Derived	Instances of And Trading Ahead And Resulting Customer Harm	Specific Stocks Referenced
Hayes	2,280 instances ($ 150,000)	5,710 instances ($ 570,000)	International Paper Co.; The Walt Disney Co.

4. ***Fleet Specialist (United States v. Foley (05 Crim. 391); United States v. Murphy (05 Crim. 397); United States v. Hunt (05 Crim. 395); and United States v. Finnerty (05 Crim. 393)***

The above-referenced indictments allege that from January 1999 to April 2003, Fleet Specialist Donald R. Foley, II ("Foley"), Thomas J. Murphy, Jr. ("Murphy"), Scott G. Hunt ("Hunt"), and David Finnerty ("Finnerty") engaged in separate schemes to trade ahead of customer orders and also to interposition proprietary trades between such orders. The allegations with respect to each of these Fleet Specialist are summarized in the following table.

Specialist	Instances of Interpositioning And Improper Profits	Instances of And Trading Ahead And Resulting Customer	Specific Stocks Referenced

	Derived	Harm	
Foley	3,710 instances	8,910 instances	Chase Manhattan
	($ 310,000)	($ 1,800,000)	Bank; JP Morgan
			Chase
Murphy	3,160 instances	6,560 instances	Johnson & Johnson;
	($ 140,000)	($ 590,000)	Electronic Data
			Systems
Hunt	1,910 instances	6,120 instances	The Goldman Sachs
	($ 150,000)	($ 940,000)	Group, Inc.;
			Cardinal Health Inc.
Finnerty	25,850 instances	15,380,000	General Electric
	($ 4,360,000)	($ 5,000,000)	Company;
			Applera-Celera
			Genomics; PE
			Biosystems

5. ***Bear Wagner LLC (United States v. Fee (05 Crim 398); United States v. Delaney (05 Crim. 394)***

The above-referenced indictments allege that between November 2000 and April 2003 Fleet Specialist Kevin M. Fee ("Fee") and Frank A. Delaney, IV ("Delaney") engaged in separate schemes to to trade ahead of customer orders and also to interposition proprietary trades between such orders. The allegations concerning these two specialists are summarized in the table below.

Specialist	Instances Of Interpositioning And Improper Profits Derived	Instances Of And Trading Ahead And Resulting Customer Harm	Specific Stocks Referenced
Fee	1,150 instances ($ 170,000)	1,310 instances (740,000)	Texas Instruments Inc.
Delaney	2,030 instances ($ 180,000)	1,510 instances ($ 390,000)	Merrill Lynch & Co, Inc.; Bank One

C. ***Allegations Concerning NYSE***

Plaintiffs assert that the NYSE and the Specialist Defendants worked together to engage in a scheme to defraud investors who traded on the NYSE. Plaintiffs contend that the NYSE actively participated in this scheme by working with the specialists to engage in improper trading activity and to evade the regulatory scrutiny that would have prevented such conduct.

It is alleged that NYSE knew that the Specialist Defendants were violating the Exchange Act and NYSE's rules by trading ahead and interpositioning. It is further alleged that NYSE deliberately failed to oversee its exchange or discipline its member for rules violations. Instead, NYSE allegedly exercised

its regulatory authority over the Specialist Defendants in a constrained manner.

More specifically, NYSE officials are alleged to have tipped off the Specialist Defendants about impending investigations, thereby permitting the Specialist Defendants to conceal their illegal trading practices. It is also alleged that NYSE officials falsified trading data by approving trade records that they knew to be false. The NYSE Division of Market Surveillance allegedly helped the Specialist Defendants identify incriminating documentation and advised them how to alter data in order to hide evidence of wrongdoing.

The Complaint also alleges that NYSE made statements that created the "public impression that the NYSE was overseeing and operating its exchange in accordance with laws, regulations and its own rules." (Compl. P139.) These statements, which are catalogued in Appendix 2 below, are alleged to be false and misleading.

The Complaint alleges that NYSE's conduct was motivated by the direct financial interest of NYSE and its top executives. The alleged components of this direct financial interest include higher trading volume and increased trading fee revenue for NYSE, higher market value for seats on the NYSE, increased NYSE enterprise value, increased NYSE listings, and increased levels of compensation for NYSE senior executives.

The NYSE announced on April 12, 2005 that it had entered into a settlement agreement with the SEC, consenting to various remedial undertakings and an order of censure by the SEC, without admitting or denying any factual allegations.

Standards

A. *Rule 12(b)(6), Rule 9(b), and the PSLRA*

Defendants have moved for dismissal of the Complaint pursuant to Fed. R. Civ. P. 12(b)(6), 9(b), and the PSLRA. In considering a motion to dismiss pursuant to Rule 12(b)(6), the Court construes the complaint liberally, "accepting all factual allegations in the complaint as true, and drawing all reasonable inferences in the plaintiff's favor." *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 152 (2d Cir. 2002) (citing *Gregory v. Daly*, 243 F.3d 687, 691 (2d Cir. 2001)).

On a Rule 12(b)(6) motion to dismiss, "mere conclusions of law or unwarranted deductions" need not be accepted. *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 771 (2d Cir. 1994). Furthermore, the truth of factual allegations that are contradicted by documents properly considered on a motion to dismiss need not be accepted. *See e.g., Rapoport v. Asia Elecs. Holding Co.*, 88 F. Supp. 2d 179, 184 (S.D.N.Y. 2000). The following materials may be considered on a Rule 12(b)(6) motion:

> (1) facts alleged in the complaint and documents attached to it or incorporated in it by reference, (2) documents "integral" to the complaint and relied upon in it, even if not attached or incorporated by reference, (3) documents or information contained in defendant's motion papers if plaintiff has knowledge or possession of the material and relied on it in framing the complaint, (4) public disclosure documents required by law to be, and that have been, filed with the Securities and Exchange Commission, and (5) facts of which

> judicial notice may properly be taken under Rule 201 of the Federal Rules of Evidence.

In re Merrill Lynch & Co. Research Reports Sec. Litig., 273 F. Supp. 2d 351, 356-57 (S.D.N.Y. 2003) (footnotes omitted).

"The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Villager Pond, Inc. v. Town of Darien*, 56 F.3d 375, 378 (2d Cir. 1995) (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974)). In other words, "'the office of a motion to dismiss is merely to assess the legal feasibility of the complaint, not to assay the weight of the evidence which might be offered in support thereof.'" *Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of New York*, 375 F.3d 168, 176 (2d Cir. 2004) (quoting *Geisler v. Petrocelli*, 616 F.2d 636, 639 (2d Cir. 1980)). Dismissal is only appropriate when "it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him or her to relief." *Sweet v. Sheahan*, 235 F.3d 80, 83 (2d Cir. 2000); *accord Eternity Global Master Fund*, 375 F.3d at 176-77.

A claim under section 10(b) sounds in fraud and must therefore meet the pleading requirements of Rule 9(b), Fed. R. Civ. P. *See, e.g., In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 69-70 (2d Cir. 2001). Such a claim must also satisfy certain requirements of the PSLRA. *See* 15 U.S.C. §§ 78u-4(b)(1) & 78u-4(b)(2); *see generally Novak v. Kasaks*, 216 F.3d 300, 306-07 (2d Cir. 2000) (setting forth the heightened pleading standards of the PSLRA that must be met by a plaintiff who alleges securities fraud under Section 10(b) and Rule 10b-5); *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1127 (2d Cir. 1994)

(stating that "securities fraud allegations under § 10(b) and Rule 10b-5 are subject to the pleading requirements of Rule 9(b)").

Rule 9(b) provides that "in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Fed. R. Civ. P. 9(b). The Second Circuit "has read Rule 9(b) to require that a complaint [alleging fraud] '(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent.'" *Rombach v. Chang*, 355 F.3d 164, 170 (2d Cir. 2004) (quoting *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1175 (2d Cir. 1993)).

In particular, the plaintiff must allege facts that "give rise to a strong inference of fraudulent intent." *Novak*, 216 F.3d at 307. The Second Circuit has stated that this scienter requirement can be satisfied:

> "'either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness.'"

Acito v. IMCERA Group, Inc., 47 F.3d 47, 52 (2d Cir. 1995) (quoting *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994)).

Rule 8's general pleading requirement and Rule 9(b)'s particularity requirement must be read together. *See Ouaknine v. MacFarlane*, 897 F.2d 75, 79 (2d Cir. 1990) (stating that "Rule 9(b) . . . must be read together with Rule 8(a) which requires only a

'short and plain statement' of the claims for relief"); *Credit & Fin. Corp. v. Warner & Swasey Co.*, 638 F.2d 563, 566 (2d Cir. 1981) (same); *In re Initial Pub. Offering Sec. Litig. ("IPO")*, 241 F. Supp. 2d 281, 327 (S.D.N.Y. 2003). These two rules have been read together to mean that a plaintiff need not plead evidentiary details. *See, e.g., id.* The Second Circuit has stated that it does "not require the pleading of detailed evidentiary matter in securities litigation." *Scholastic*, 252 F.3d at 72.[6] Courts of this district have stated that "the application of Rule 9(b) . . . must not abrogate the concept of notice pleading." *IPO*, 241 F. Supp. 2d at 327 n.46.

B. ***Section 10(b) and Rule 10b-5***

Section 10(b) of the Exchange Act provides in pertinent part as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention

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[6] *See also Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1225 (1st Cir. 1996)* (stating that "in determining the adequacy of a complaint under [*Rule 9(b)*], we cannot hold plaintiffs to a standard that would effectively require them, pre-discovery, to plead evidence").

> of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors

15 U.S.C. § 78j.

Rule 10b-5 provides in pertinent part as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

"The language of Section 10(b) and Rule 10b-5 does not explicitly create a private right of action. In fact, the legislative history fails to indicate whether Congress even contemplated creating such a right . . . . Nevertheless, courts long have held that a private right of action was indeed created." *Ontario Public Service Employees Union Pension Trust Fund v. Nortel Networks Corp.*, 369 F.3d 27, 31 (2d Cir. 2004).

To state a claim under Section 10(b) and Rule 10b-5 a plaintiff must plead that the defendant: "(1) made misstatements or omissions of material fact; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiff[] relied; and (5) that plaintiff['s] reliance was the proximate cause of [the] injury." *In re Livent, Inc. Sec. Litig.*, 78 F. Supp. 2d 194, 213 (S.D.N.Y. 1999).

C. ***Section 20(a)***

Section 20(a) provides as follows:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable . . . to the same extent as such controlled person . . . unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a).

In order to plead control person liability under Section 20(a), a plaintiff must "allege a primary § 10(b) violation by a person controlled by the defendant and culpable participation by the defendant in the perpetration of the fraud." *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001) (holding that plaintiffs had stated a Section 20(a) claim against defendant bank where it was alleged that: (1) the person who had committed the alleged violation of Section 10(b) was an officer of the bank, and (2) the officer was responsible for the bank's relationship with a venture whose securities were the subject of the alleged Section 10(b) violation).

D. ***Section 6(b)***

Section 6(b) of the Exchange Act provides in pertinent part that:

> An exchange shall not be registered as a national securities exchange unless the Commission determines that –
>
> (1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this chapter and to comply, and . . . to enforce compliance by its members . . . with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange.
>
> * * *
>
> (5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers . . .
>
> (6) The rules of the exchange provide that . . . its members and persons associated with its members shall be appropriately disciplined for violation of . . . the rules of the exchange . . . .

15 U.S.C. § 78f(b).

E. ***Common Law Breach of Fiduciary Duty***

Under New York law, the elements of a fiduciary duty claim are: (1) the existence of a fiduciary relationship, and (2) a breach of the duty arising from that relationship. *See, e.g., Official Comm. of Asbestos Claimants of G-I Holding, Inc. v. Heyman*, 277 B.R. 20, 37 (S.D.N.Y. 2002). A fiduciary relationship may be found "when one [person] is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation." *Flickinger v. Harold C. Brown & Co.*, 947 F.2d 595, 599 (2d Cir. 1991) (citation omitted).

A claim for aiding and abetting a breach of fiduciary duty requires the plaintiff to prove "(1) the existence of a violation committed by the primary (as opposed to the aiding and abetting) party; (2) 'knowledge' of this violation on the part of the aider and abettor; and (3) 'substantial assistance' by the aider and abettor in achievement of the violation." *Briarpatch Ltd. L.P. v. Geisler Roberdeau, Inc.*, 2002 U.S. Dist. LEXIS 20789, No. 99 Civ. 9623, 2002 WL 31426207, at *7 (S.D.N.Y. Oct. 30, 2002).

Discussion

A. ***The Claims Against NYSE Are Dismissed With Prejudice***

NYSE has sought dismissal of the claims against it on the grounds that claims arising from NYSE's allegedly improper exercise of its regulatory authority are barred by a doctrine of absolute immunity. Plaintiffs argue that NYSE is not shielded by immunity for knowingly operating its auction market in a fraudulent manner.

1. ***The Section 6(b), 20(a), 10(b) Fraudulent Scheme, and State Law Aiding and Abetting Breach of Fiduciary Duty Claims***

NYSE is registered with the SEC as a national securities exchange pursuant to *Section 6* of the Exchange Act. *See* 15 U.S.C. § 78f. As such, it is a self-regulatory organization ("SRO") within the meaning of the Exchange Act. *See* 15 U.S.C. § 78c(a)(26). The Exchange Act delegates to NYSE, as an SRO, the authority to regulate its members and to enforce its members' compliance with the Exchange Act, the rules and regulations thereunder, and NYSE rules. *See* 15 U.S.C. § 78s(g)(1). The Exchange Act provides the SEC with broad and exclusive authority to oversee: (1) NYSE's compliance with the Exchange Act, the rules and regulations thereunder, and its own rules; and (2) NYSE's enforcement of its members compliance with these provisions. *See* 15 U.S.C. §§ 78s(g)(1) and 78s(h)(1). The Exchange Act also empowers the SEC to take adverse action against NYSE should it fail to fulfill these duties, including such far-reaching measures as a revocation of NYSE's registration as an SRO, suspension for a period of up to 12 months, and censure. *Id.*

The Second Circuit has held that "the NYSE, when acting in its capacity as an SRO, is entitled to immunity from suit when it engages in conduct consistent with the quasi-governmental powers delegated to it pursuant to the Exchange Act and the regulations and rules promulgated thereunder." *D'Alessio v. New York Stock Exch. Inc.*, 258 F.3d 93, 106 (2d Cir. 2001) (affirming dismissal of tort and contract claims asserted against NYSE by stock broker who alleged that he had been wrongly prosecuted and suspended from trading on the

NYSE); *see also DL Capital Group, LLC v. NASDAQ Stock Market, Inc.*, 409 F.3d 93, 97 (2d Cir. 2005) (holding Nasdaq absolutely immune from suit challenging manner in which Nasdaq publicly announced suspension or cancellation of trades); *MFS Sec. Corp. v. New York Stock Exch., Inc.*, 277 F.3d 613, 617 (2d Cir. 2002) (holding NYSE immune from contract claim by securities firm that had been stripped of its NYSE membership); *Barbara v. New York Stock Exch., Inc.*, 99 F.3d 49, 50 (2d Cir. 1996) (holding NYSE "absolutely immune from damages arising out of performance of its federally mandated conduct of disciplinary proceedings").

In so holding, the *D'Alessio* court reasoned that the NYSE, as an SRO, "stands in the shoes of the SEC in interpreting the securities laws for its members and in monitoring compliance with those laws. . . . [Therefore,] the NYSE should be entitled to the same immunity enjoyed by the SEC when it is performing functions delegated to it under the SEC's broad oversight authority." *D'Alessio*, 258 F.3d at 105; *see also DL Capital*, 409 F.3d at 97 (noting that "because the NYSE performs a variety of regulatory functions that would, in other circumstances, be performed by [the SEC] . . . the NYSE should . . . out of fairness be accorded full immunity from suits for money damages).

In *D'Alessio,* it was alleged that in order to generate revenue from trading practices that it knew to be illegal, the NYSE had: (1) disseminated interpretations of federal securities law and NYSE rules that it knew to be false; (2) failed to properly monitor the trading practices of floor brokers; and (3) provided false information to the SEC and the United

States Attorney's Office. *Id.* at 106. The *D'Alessio* court determined that:

> the NYSE's alleged improper interpretation of the type of conduct prohibited under section 11(a) falls within the NYSE's "quasi-public adjudicatory" duties. Similarly, the NYSE acted in its adjudicatory capacity when it determined that [plaintiff] D'Alessio was guilty of violating section 11(a) and various rules of the NYSE and suspended him from further trading on the NYSE floor. Because these actions "share the characteristics of the judicial process," *Barbara*, 99 F.3d at 59 (quotation marks omitted), the NYSE is entitled to immunity from suit for claims based on these actions. In charging D'Alessio with misconduct and referring his case to the United States Attorney's Office and the SEC, the NYSE exercised its authority pursuant to its "quasi-prosecutorial" function. *Finally, any malfeasance on the part of the NYSE in failing to monitor D'Alessio's and other floor brokers' compliance with the prohibition under section 11(a) plainly falls within the scope of the quasi-governmental duties delegated to the NYSE under the Exchange Act.*

Id. at 106 (emphasis added).

Here, Plaintiffs' allegations that NYSE deliberately failed to supervise and discipline the specialist firms (*see, e.g.*, Compl. PP5, 8, 188, 193, 227, 228) are indistinguishable from those dismissed in *D'Alessio*. Plaintiffs argue that the two cases are distinguishable on the grounds that in the present case, it is alleged that NYSE's misconduct was motivated by non-regulatory business considerations (*i.e.*, the desire to maximize the compensation of

NYSE executives and the revenues of NYSE members) that were not present in *D'Alessio*. This argument ignores the fact that the *D'Alessio* complaint alleged that the NYSE's misconduct had been motivated, at least in part, by an interest in the substantial fees earned by the NYSE and by a desire to increase NYSE's daily volume of trading activity. *Id.* at 98. As in *D'Alessio,* the NYSE's alleged misconduct falls within the scope of its quasi-governmental authority.

Plaintiffs also attempt to distinguish the Second Circuit's prior decisions concerning the absolute immunity of SRO's on the grounds that those cases involved suits by current or former members of the NYSE and not those brought by customers of the exchange. However, as stated by the *D'Alessio* court, NYSE's entitlement to immunity hinges solely on whether the alleged conduct giving rise to the claim was quasi-governmental in nature. *Id.* at 106. Neither the nature of the plaintiff's relationship with the SRO nor the nature of the plaintiff's claims are relevant to this analysis. As the Second Circuit recently reaffirmed: "This Court has never suggested that the identity of the plaintiff is what drives the absolute immunity analysis. Rather, we have made clear that it is the SRO's *function* as a quasi-governmental authority that entitles it to absolute immunity." *DL Capital, 409 F.3d at 99* (citing *D'Alessio at 104-05*) (emphasis in original).

Finally, it should be noted that the Second Circuit's recognition of this absolute immunity was motivated, in large measure, by an interest in ensuring that the "'exercise of [SROs'] quasi-governmental functions would [not] be unduly hampered by disruptive and recriminatory lawsuits.'" *Id.* at 105 (quoting *D'Alessio*

v. New York Stock Exch., Inc., 125 F. Supp. 2d 656, 658 (S.D.N.Y. 2000)).

Based on the foregoing, it is determined that NYSE has absolute immunity with respect to Plaintiffs' *Section 6(b)*, *Section 20(a)*, *Section 10(b)* fraudulent scheme, and state law fiduciary duty claims, all of which are based on NYSE's failure to adequately monitor the conduct of the Specialist Defendants. Therefore, these claims are dismissed with prejudice with respect to NYSE.

2. ***The Section 10(b) Fraudulent Statement Claims***

Plaintiffs have also alleged that statements by NYSE concerning NYSE's duties to its customers were false and misleading in violation of section 10(b). Some of these statements appear primarily promotional in nature. (*See, id.* PP140-43, 145, 147 150-53[7]). Such statements would not appear to be protected by NYSE's absolute immunity for quasi-governmental functions.

However, Plaintiffs lack standing to assert a Section 10(b) claim based on the statements identified in the Complaint. The Second Circuit has held that standing to assert a fraudulent misrepresentation claim pursuant to Section 10(b) and Rule 10b-5 is limited to plaintiffs "'who have at least dealt in the security to which the prospectus, representation, or omission relates.'" *Ontario Pub. Serv. Employees*

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[7] The Complaint does not identify in what type of document the statement in paragraph 153 appeared. However, the text is promotional in tone. Moreover, with respect to this statement, NYSE has failed to carry its burden of demonstrating that it is entitled to immunity from suit. *See D'Alessio*, 258 F.3d at 104 (citing *Butz v. Economou*, 438 U.S. 478, 506, 98 S. Ct. 2894, 57 L. Ed. 2d 895 (1978)).

Union Pension Trust Fund v. Nortel Networks Corp., 369 F.3d 27, 32 (2d Cir. 2004)[8] (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 747, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975) (applying *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952))), *cert. denied sub nom. Visnic v. Nortel Networks Corp.*, 543 U.S. 1050, 125 S. Ct. 919, 160 L. Ed. 2d 771 (2005).

Here, the representations at issue do not relate to any particular security, or to any security purchased or sold by any of the Plaintiffs. Rather, the alleged misstatements all concern NYSE's capacity to operate an efficient securities market. Under *Nortel*, Section 10(b) confers no standing on Plaintiffs to challenge statements such as these, *i.e.*, statements by a non-issuer about a non-issuer. *See Nortel*, 369 F.3d at 33.

Citing *Blue Chip Stamps*, 421 U.S. 723, 95 S. Ct. 1917, 44 L. Ed. 2d 539, Plaintiffs argue that in order to have standing under Section 10(b) and Rule 10b-5, they merely must be purchasers or sellers of the securities that are the subject of the action. This argument was considered and rejected by the *Nortel* court, which stated:

> [Plaintiffs] claim that they have met the *Blue Chip Stamps* standing requirements because they purchased the security at issue in their lawsuit. They base this argument on the

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[8] The *Nortel* court held that shareholders of JDS Uniphase Corporation ("JDS") lacked standing to assert a *Section 10(b)* misrepresentation claim against Nortel Networks Corporation ("Nortel") based on Nortel's alleged misstatements made in connection with the sale of a business unit to JDS. The alleged misstatements concerned Nortel's business operations and not those of JDS.

references in *Section 10(b)* and *Rule 10b-5* to fraudulent conduct "in connection with the purchase or sale of *any* security." 15 U.S.C. § 78j(b), 17 C.F.R. § 240.10b-5 (emphasis added). In plaintiffs' view, the word "any" indicates that the intent of Congress and the SEC was to create universal standing for purchasers of securities, allowing anyone who made use of the markets to sue under Rule 10b-5. They further argue that this interpretation is consistent with the Supreme Court's understanding that Congress intended Section 10(b) to be interpreted flexibly to protect against the ever-evolving nature of securities fraud. *Affiliated Ute Citizens v. United States*, [406 U.S. 128, 151, 92 S. Ct. 1456, 31 L. Ed. 2d 741] (1972).

Plaintiffs assume that the phrase "any security" includes securities of any company affected in some way by the misrepresentation and not just securities of the company that makes the material misstatements. However, in our view, the phrase indicates that the regulations reach all types of securities, and not any affected company's securities. *See* Thomas Lee Hazen, The Law Of Securities Regulation § 12.4 (4th ed. 2002) (explaining that Rule 10b-5's "any security" language means that it applies to all types of securities, even those that are exempt from registration). Furthermore, plaintiffs' interpretation of this passage is entirely at odds with the purchaser-seller requirement in *Blue Chip Stamps* that "limits the class of plaintiffs to those who have at least dealt in the security to which

> the prospectus, representation, or omission relates." *Blue Chip Stamps*, [421 U.S. at 747].

Nortel, 369 F.3d at 32.

In the alternative, Plaintiffs argue that the *Blue Chip Stamps/Nortel* standing requirement is satisfied here because NYSE's statements related to the market on which the securities at issue were traded. Plaintiffs have cited no authority to support its argument that general statements concerning the integrity of a securities market are tantamount to statements about specific securities traded on that market. Moreover, to recognize standing on this basis might have the undesirable effect of exposing a given securities exchange to litigation by disappointed investors whenever it could be shown that the exchange made a material misstatement or omission about its operations.

Based on the foregoing, it is determined that Plaintiffs' Section 10(b) misstatement/omission claim against NYSE are dismissed with prejudice.

B. ***The State Law Claims Are Dismissed***

The Specialist Defendants argue that the state law fiduciary duty claims asserted in Counts Five and Six of the Complaint are preempted under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). *See* 15 U.S.C. §§ 77p, 78bb(f). SLUSA provides, in pertinent part, as follows:

> No covered class action[9] based upon the statutory or common law of any State or

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[9] SLUSA defines a "covered class action" as:

(i) any single lawsuit in which—

subdivision thereof may be maintained in any State or Federal court by any private party alleging

(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security;[10] or

(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which—

(I) damages are sought on behalf of more than 50 persons; and

(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

15 U.S.C. § 78bb(f)(5)(B).

[10] SLUSA defines a "covered security" as "a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) of the Securities Act of 1933 [(the "Securities Act")], at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred . . . ." 15 U.S.C. § 78bb(f)(5)(E). Section 18(b) of the Securities Act includes securities that are listed or authorized for listing on certain national securities exchanges. *See* 15 U.S.C. § 77r(b)(1).

15 U.S.C. § 78bb(f)(1). SLUSA also provides that any such action may be removed to federal court. 15 U.S.C. § 78bb(f)(2).

As stated by the Second Circuit:

> Congress enacted SLUSA in 1998 in response to the perceived failure of the PSLRA to achieve its goals. Congressional investigation revealed a "federal flight" loophole whereby many class action plaintiffs avoided the PSLRA's heightened requirements by bringing suit in state courts under state statutory or common law rather than in federal court. [Citations omitted.] In enacting SLUSA, Congress intended to close this loophole "by making federal court the exclusive venue for class actions alleging fraud in the sale of certain covered securities and by mandating that such class actions be governed exclusively by federal law." [Citation omitted.]

Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 395 F.3d 25, 32 (2d Cir. 2005). Furthermore, the Second Circuit has determined that in enacting SLUSA, Congress evidenced a clear intention "'to completely preempt the field of certain types of securities class actions by essentially converting a state law claim into a federal claim and creating federal jurisdiction and venue for specified types of state securities fraud claims.'" *Id.* (quoting *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 332 F.3d 116, 123 (2d Cir. 2003)).

There is no dispute here that this action qualifies as a "covered class action" and that the alleged conduct was "in connection with" the purchase or sale of a "covered security." Nor is there any dispute that breach of fiduciary duty claims are based on state

common law. Rather, the parties dispute whether or not Plaintiffs fiduciary duty claims sound in fraud, thereby triggering SLUSA preemption.

The Second Circuit has stated that SLUSA preemption and removal is triggered in lawsuits in which the plaintiff alleges state law violations stemming from a misstatement, omission, or manipulative conduct in connection with the purchase or sale of a covered security. *See Spielman*, 332 F.3d at 124 (2d Cir. 2003).

The Specialist Defendants argue that Plaintiffs fiduciary duty claims are based entirely on the same allegations that underpin their Exchange Act claims and therefore, that SLUSA preemption is triggered. Plaintiffs counter that SLUSA preemption is not triggered here because no misstatement or omission was a necessary condition of their fiduciary duty claims.

As stated in the Complaint, the gravamen of the fourth claim is that the unlawful conduct described elsewhere in the Complaint constituted a violation of the fiduciary duties owed by the Specialist Defendants to the Plaintiffs. As stated in the Complaint, the gravamen of the fifth cause of action is that the Brokerage Defendants breached fiduciary duties owed to the Plaintiffs by: (1) causing and/or permitting Plaintiffs' orders to be executed at disadvantageous prices in violation of NYSE rules, and (2) failing to disclose material facts concerning the conduct of the Specialist Defendants.

As pled by the Plaintiffs, the fourth claim stems from alleged manipulative conduct. As pled by the Plaintiffs, the fifth claim stems, at least in part, from alleged material omissions. As such, both claims are

preempted by SLUSA. This outcome is not changed by the fact that Plaintiffs have disclaimed any incorporation of fraud allegations into their fiduciary duty claims. *See, e.g., Norman v. Salomon Smith Barney, Inc.*, 350 F. Supp. 2d 382, 386 (S.D.N.Y. 2004) (stating that "plaintiffs may not avoid SLUSA pre-emption simply by artful pleading that avoids the actual words 'misrepresentation' or 'fraud[]'").

Plaintiffs have failed to identify an instance in which a court has determined that SLUSA permits the assertion of pendent state law claims based on the same conduct that underpins a plaintiff's Section 10(b) claims. Instead, Plaintiffs rely heavily on a single case from this district in which no *Section 10(b)* claim was asserted. *See Xpedior Creditor Trust v. Credit Suisse First Boston (USA) Inc.*, 341 F. Supp. 2d 258, 268 (S.D.N.Y. 2004) (holding that SLUSA preemption was not triggered where all claims were based on state law and none of the claims were based on fraudulent conduct).

The Plaintiffs argue that this Court should adopt the so-called "necessary component" test articulated by the *Xpedior* court. *See id.* As stated by the *Xpedior* court:

> Regardless of the words used by plaintiffs in their complaints and regardless of the labels they paste on each claim, the question is whether a material misstatement or omission in connection with the purchase or sale of a covered security is a *necessary component* of the claim. To make this determination the simple inquiry is whether plaintiff is pleading fraud in words or substance. . . . the real question [is] whether the claim [is] based on fraudulent conduct, regardless of

> the appearance of the words "fraud" or "misrepresentation."

Id. (emphasis in original) (canvassing district court cases to determine proper application of *Spielman* court's requirement that courts probe plaintiff's pleadings to determine whether SLUSA preemption applies).

The *Xpedior* court's holding provides a useful articulation of the criteria for determining whether SLUSA preemption has been triggered. Plaintiffs arguments that the fourth and fifth claims are not based on "fraud" and "misrepresentation" notwithstanding, the Complaint's allegations demonstrate that these claims are based on fraudulent conduct. Therefore, fraud was a necessary component of these claims, and they are preempted pursuant to SLUSA.

Based on the foregoing, it is determined that the state law claims asserted in Counts Four and Five of the Complaint are dismissed with prejudice as to all defendants.

C. *Dismissal of the Claims Against The Specialist Defendants Is Not Warranted Under Section 28(a) Of The Exchange Act*

The Specialist Defendants argue that Plaintiffs' claims, to the extent that they are based on the conduct described in the Settlement Orders, are barred by Section 28(a) of the Exchange Act, which provides, in pertinent part, that "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in

excess of his actual damages on account of the act complained of . . . ." 15 U.S.C. § 78bb(a).[11]

The Specialist Defendants argue that the Settlement Orders precisely calculated the customer disadvantage that resulted from their alleged improper conduct and that the Settlement Orders provide for full restitution (including interest) to customers allegedly affected by that conduct. The Plaintiffs argue that the alleged fraudulent and manipulative scheme at issue in this action exceeds the conduct uncovered in the SEC's investigation. Furthermore, the Plaintiffs argue that the Specialist Defendants' double recovery argument is premature in that until there is a pool of evidence relating to violations and damages for the current action, no determination can be made as to the extent of the overlap with the SEC settlements.

The Specialist Defendants rely heavily on two decisions from outside this circuit to support the argument that dismissal is warranted at this early phase of the litigation pursuant to *Section 28(a)*. *See Friedman v. Bache Halsey Stuart Shields, Inc.*, No. 80 C 1111, 1985 U.S. Dist. LEXIS 21106 (D. Ill. Apr. 2, 1985) (dismissing claims by plaintiff who had previously recovered the full amount of actual damages, as fixed based on plaintiff's previous responses to interrogatories); *In re Nat'l Mortg. Equity Corp. Mortg. Pool Certificates Sec. Litig.*, 636 F. Supp. 1138 (D. Cal. 1986) (holding that the single-

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[11] The Second Circuit has stated that *Section 28(a)* has two general purposes. *See Osofsky v. Zipf, 645 F.2d 107, 111 (2d Cir. 1981)*. First, it is intended "to prevent double recovery by those who assert both state and federal claims arising out of the same conduct." *Id.* Second, it prohibits the recovery of punitive damages in private actions based on alleged violations of the Exchange Act. *Id.*

recovery rule and the rules of contribution and indemnity barred a tortfeasor from asserting direct claims that had been assigned to it by an injured party that received full compensation for its injuries in exchange).[12]

As suggested by their ideosyncratic fact patterns, *Friedman* and *National Mortgage* are both distinguishable from the present case. In *Friedman,* it was undisputed that plaintiff's losses from defendants' fraud did not exceed the $ 508,338 that plaintiff had previously received in settlement funds, thereby permitting the court to determine as a matter of law that his claim was barred by the single-recovery rule. *Friedman*, 1985 U.S. Dist. LEXIS 21106, at *2-3. The *National Mortgage* decision was animated in large measure by the Court's concern that the assignment of the injured parties' claim to the plaintiff was effected for the purpose of permitting the plaintiff to circumvent the rules applicable to actions for contribution and/or indemnity. *See Nat'l Mortg.*, 636

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[12] *National Mortgage* involved an alleged fraudulent scheme in connection with the sale of mortgage pool certificates to savings and loan associations (the "Investor Institutions"). *Id. at 1145-47.* Pursuant to this scheme, defendants engaged in sham mortgage transactions between related entitites that diverted the Investor Institutions' funds for defendants' personal benefit. *Id.* One of the plaintiffs, Bank of America ("BoA"), asserted claims brought in its own right and as assignee of nineteen Investor Institutions. *Id.* BoA was trustee to certain of these mortgage pools. *Id.* In this capacity, BoA was responsible for reviewing mortgages to determine whether they qualified for inclusion in a given pool. *Id.* In a subsequent internal investigation, BoA determined that certain of its employees had not adequately discharged their duties in connection with BoA's role as trustee. *Id.* According to BoA, it resolved its potential liability to the Investor Institutions by repurchasing its certificates or by replacing the mortgages in the affected mortgage pools. *Id.* In return, the Investor Institutions assigned to BoA any claims they might have against the defendants. *Id.*

F. Supp. at 1150-51. Moreover, there was no dispute in *National Mortgage* as to whether the amount that the plaintiff paid to the injured parties was equivalent to the full value of the losses they suffered as a result of the fraudulent scheme.

In contrast, there is a dispute here as to whether the sums paid by the Specialist Defendants pursuant to Settlement Orders are equivalent to the full value of the losses suffered by the Plaintiffs. Moreover, the structure of the SEC-administered distribution funds evidence a substantial degree of uncertainty concerning the SEC's calculations concerning the magnitude of the losses suffered by customers as a result of the Specialist Defendants' conduct. Pursuant to the Settlement Orders, each specialist firm was required to disgorge funds equivalent to the SEC's calculation of the customer disadvantage caused by that firm's conduct. However, the distribution fund for each specialist firm (*i.e.*, the fund established to facilitate reimbursement of customers for their losses) includes not only disgorgement but also the civil penalties imposed on the specialist firm. The following table provides a summary of the value of each specialist firm's distribution fund in comparison to the value of the customer disadvantage allegedly caused by that firm's conduct.

Specialist Firm	SEC's Calculation Of Total Customer Disadvantage Caused	Total Size Of Distribution Fund Established	Percentage Difference
LaBranche LLC	$ 41,646,440	$ 63,518,760	52%
Spear Leeds	$ 28,776,072	$ 45,272,478	57%

Specialist Firm	SEC's Calculation Of Total Customer Disadvantage Caused	Total Size Of Distribution Fund Established	Percentage Difference
LLC			
VDM Specialists	$ 34,926,613	$ 57,675,104	65%
Fleet Specialist	$ 38,013,594	$ 59,097,469	55%
Bear Wagner LLC	$ 10,724,903	$ 16,259,446	52%
SIG Specialists	$ 2,045,571	$ 988,018	48%
Performance Specialist	$ 1,491,171	$ 680,761	46%

The fact that the overall size of each of the distribution funds exceeds the calculated customer disadvantage may suggest that the SEC and the Specialist Defendants anticipated that actual disadvantage suffered by customers was likely to exceed the SEC's calculations as to the total value of such disadvantage. In short, the facts alleged support the inference that the customer disadvantage calculations contained in the Settlement Orders were no more than estimates of the total amount of customer disadvantage caused by Specialist Defendants, and do not constitute caps on the amount of damages that could be recovered by the Plaintiffs.

Under these circumstances, and in the absence of any controlling authority requiring this Court to adopt the SEC's calculations concerning the value of the losses suffered by the Plaintiffs, Section 28(a) does not compel dismissal at this state of the litigation. *See, e.g., Hayes v. Gross*, 982 F.2d 104, 109 (3d Cir. 1992) (stating that dismissal of an otherwise well-pleaded claim is not warranted where "double recovery is not inherent in plaintiff's theory of the case and, accordingly, that recovery without duplication is possible"). Rather, in the event that Plaintiffs' claims are otherwise viable, the proper course is for discovery to go forward and for the Specialist Defendants to interpose the double-recovery defense at an appropriate phase of this litigation. *See id.* (stating that a double-recovery defense should be evaluated "in the specific fact context presented by plaintiff's case on damages").

In opposition to the Specialist Defendants argument with respect to the single-recovery rule, Plaintiffs have argued that the following text, which appears in identical form in each of the Settlement Orders, denies the Specialist Defendants any offset of damages in related investor actions:

> To preserve the deterrent effect of the civil penalty, Respondent agrees that it shall not, in any Related Investor Action, benefit from any offset or reduction of any investor's claim by the amount of any Fair Fund distribution to such investor in this proceeding that is proportionately attributable to the civil penalty paid by Respondent ("Penalty Offset"). If the court in any Related Investor Action grants such an offset or reduction, Respondent agrees that it shall, within 30 days after entry of a final order

> granting the offset or reduction, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed against Respondent in this proceeding.

(Bear Wagner Specialists LLC, Order Instituting Administrative and Cease-and-desist Proceedings . . ., No. 49498, 2004 WL 626586, at *11 (Mar. 30, 2004)).

Plaintiffs' interpretation of this passage flies in the face of the well-settled rule that a plaintiff is entitled to only one satisfaction for each injury. *See, e.g., Singer v. Olympia Brewing Co.*, 878 F.2d 596, 600 (2d Cir. 1989) (quoting *Restatement (Second) of Torts* § 885(3) (1979)). As suggested by the Specialist Defendants, the more natural reading of the passage is that it prevents the use of civil penalty payments to offset civil damages. The following hypothetical is illustrative.

Assume that a given specialist firm was required to pay $50 in civil penalties and $50 in disgorgement. Pursuant to the standard terms of the settlement order, all $100 of these funds would be added to a distribution fund to be distributed to customers disadvantaged by that specialist's conduct. Assume that $51 of the fund (*i.e.*, $50 of disgorgement funds and $1 of civil penalty funds) is distributed to customers by the distribution fund's administrator. Assume further that in a subsequent civil action, it is determined that these same customers suffered $52 of losses as a result of the specialist firm's conduct.

Finally, assume that the court ordered the customers' $52 recovery offset by the $51 previously received from the fund. Pursuant to the above-described provision of the Settlement Orders, the specialist firm would be required to pay the amount of the penalty offset (*i.e.*, $1) to the United States Treasury or to the distribution fund. In this way, the specialist firm is prevented from dipping into the civil penalties paid to the SEC in order to offset its civil liability. But as demonstrated by the foregoing hypothetical, no plaintiff is permitted to recover more than the total value of the loss suffered by that defendant.

Finally, it should be noted that the above-described provision provides further support for the determination that this action is not barred by the single-recovery rule. That is, the provision supports the inference that both the SEC and the Specialist Defendants anticipated that private investor actions would proceed in tandem with the distribution of the SEC settlement funds and that damage awards in such actions might exceed the total value of customer disadvantage, as calculated by the SEC.

Based on the foregoing, it is determined that the single-recovery rule embodied in *Section 28(a)* of the Exchange Act does not warrant dismissal of this action at this stage of the litigation.

D. ***Plaintiffs Have Stated A Section 10(b) Manipulative Scheme Claim Against The Specialist Firms, LaBranche LLC and VDM Holding***

Count One of the Complaint alleges, in part, that the defendants violated Section 10(b) of the Exchange Act by engaging in a manipulative scheme that caused the plaintiffs and other NYSE customers to

purchase or sell shares at distorted and manipulated prices. A court of this district has recently provided the following guidance with respect to the pleading requirements for fraudulent scheme claims.

First, in order to satisfy Rule 9(b) and the PSLRA, a manipulative scheme claim must specify must specify "[1] what manipulative acts were performed, [2] which defendants performed them, [3] when the manipulative acts were performed, and what effect the scheme had on the market for the securities at issue." *S.E.C. v. U.S. Environmental, Inc.*, 82 F. Supp. 2d 237, 240 (S.D.N.Y. 2000). Second, scienter must be alleged. *Id.* Third, a plaintiff need not "plead every manipulative stock trade individually[.]" *Id.* Rather, it is adequate to couple detailed descriptions of a few sample trades with more general allegations. *Id.* Fourth, plaintiff must satisfy Rule 9(b) as to each individual defendant and "cannot do so by making vague allegations about the defendants as a unit[.]" *Id.* at 241.

1. ***Plaintiffs' Allegations Concerning Pennying, Freezing The Book, and 1998 Conduct***

The Specialist Defendants argue that certain of the Complaint's allegations, which are said to be beyond the scope of the conduct alleged in the Settlement Orders, have not been pled with requisite particularity pursuant to Rule 9(b) and/or fail to state a claim upon which relief can be granted. The Specialist Defendants have identified three such categories of add-on allegations: (1) pennying (*see* Compl. PP78-79); (2) freezing the book (*see id.* PP90-104); and (3) interpositioning and trading ahead for some 2.5 months at the end of 1998 (*see id.* P136).

First, it is determined that the term "pennying" is used in the Complaint merely as a synonym for

interpositioning. Indeed, the Complaint contains no allegations relating specifically and solely to pennying. To the extent that the Plaintiffs intended to allege a manipulative practice known as pennying that is distinct from interpositioning, such allegations must be dismissed pursuant to *Rule 9(b)* for lack of particularity.

Second, it is determined that as used in the Complaint, the term "freezing the book," describes a tactic used by the Specialist Firms to facilitate interpositioning and trading ahead. During discovery, Plaintiffs are entitled to inquire into whether and to what extent the Specialist Firms employed the technique of freezing the Display Book. However, Plaintiffs' have failed to identify any specific instances in which any of the Specialist Firms engaged [**77] in freezing the Display Book. Therefore, to the extent that the Plaintiffs have alleged a manipulative practice known as "freezing the book" that is distinct from interpositioning or trading ahead, such allegations must be dismissed pursuant to Rule 9(b) for lack of particularity.

Third, the Specialist Defendants argue that Plaintiffs' claims based on alleged trading from October 17 to December 31 of 1998 are barred by the applicable statute of limitations.[13] Plaintiffs have not

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[13] Pursuant to Section 804 of the Public Company Accounting Reform and Investor Protection Act of 2002 (the "Sarbanes-Oxley Act"), Pub.L. No. 107-204, 116 Stat. 745 (2002), a complaint filed on or after July 30, 2002 asserting a private securities fraud claim "may be brought no later than the earlier of (1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation." 28 U.S.C. § 1658(b). The limitations period in Sarbanes-Oxley applies both to claims brought pursuant to sections 10(b) and 20(a) of the Exchange Act. *See, e.g., Marcus v. Frome*, 329 F. Supp. 2d 464, 475 (S.D.N.Y. 2004); *see also*

seriously opposed the Specialist Defendants' motion with respect to the 1998 claims. Therefore, the Complaint is dismissed with prejudice with respect to conduct that is alleged to have occurred between October 17 and December 31 of 1998.

2. *With Respect To Interpositioning and Trading Ahead, Scienter Has Been Adequately Pled As To The Specialist Firms, LaBranche & Co., M. LaBranche, and VDM Holdings*

In their separate motions to dismiss, the Specialist Defendants and the SIG defendants do not seriously challenge whether the Plaintiffs have stated a Section 10(b) manipulative scheme claim with respect to at least some of the conduct alleged in the

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Dodds v. Cigna Sec., Inc., 12 F.3d 346, 350 n.2 (2d Cir. 1993) (stating that a Section 20 claim based on a Section 10(b) violation is governed by the Section 10(b) statute of limitations).

The Second Circuit has held that Section 804 of the Sarbanes-Oxley Act does not function retroactively, and, therefore, it cannot revive claims that were stale as of July 30, 2002, the date of Sarbanes-Oxley's enactment. *See Enterprise Mortg. Acceptance Co., LLC, Sec. Litig. v. Enterprise Mortg. Acceptance Co.*, 391 F.3d 401, 406 (2d Cir. 2004).

Prior to the enactment of Sarbanes- Oxley,

> the statute of limitations for claims pursuant to *section 10(b) of the Securities Exchange Act* and *SEC Rule 10b-5* [was] "within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e) (2000). "Discovery of facts for the purposes of this statute of limitations includes constructive or inquiry notice, as well as actual notice." *Rothman v. Gregor*, 220 F.3d 81, 96 (2d Cir.2000) (internal quotation marks omitted); *see also Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 350 (2d Cir. 1993). "A plaintiff in a federal securities case will be deemed to have discovered fraud for purposes of triggering the statute of limitations when a reasonable investor of ordinary intelligence would have discovered the existence of the fraud." *Dodds*, 12 F.3d at 350.

Newman v. Warnaco Group, Inc., 335 F.3d 187 at 193.

Settlement Orders and further alleged in the April, 2005 indictments.[14] Rather, they argue that Plaintiffs have failed to adequately plead scienter beyond those trades involving the individual stocks specified in the Settlement Orders.

The Second Circuit has stated that in order to plead scienter, "'the requisite intent of the alleged [perpetrator of the fraud] need not be alleged with great specificity.'" *Wight v. BankAmerica Corp.*, 219 F.3d 79, 91 (2d Cir. 2000) (quoting *Chill v. General Elec. Co.*, 101 F.3d 263, 267 (2d Cir. 1996) (citing *Cohen*, 25 F.3d at 1173)). Rather, plaintiffs need only plead "'circumstances that provide at least a minimal factual basis for their conclusory allegations of scienter.'" *Cohen v. Koenig*, 25 F.3d 1168, 1173 (2d Cir. 1994) (quoting *Connecticut Nat'l Bank v. Fluor Corp.*, 808 F.2d 957, 962 (2d Cir. 1987)). Courts of this district have observed that while scienter cannot be adequately alleged based on generalized allegations concerning the existence of a scheme, it is sufficient for the purposes of pleading scienter for a complaint to couple broader allegations with detailed descriptions of sample trades. *See, e.g., Endovasc Ltd. v. J.P. Turner & Co., LLC*, 2004 U.S. Dist. LEXIS 5075, No. 02 Civ. 7313 (LAP), 2004 WL 634171, at *13 (S.D.N.Y. Mar. 30, 2004) (citing *S.E.C. v. U.S. Envtl, Inc.*, 82 F. Supp. 2d 237, 240 (S.D.N.Y. 2000)).

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[14] That is, it has been alleged that between January 1999 through 2003, the Specialist Defendants breached their duty to refrain from dealing for their own accounts while in possession of executable buy and sell customer orders. It is alleged that the Specialist Defendants effected improper proprietary trades at the expense of customer orders. Such improper trading allegedly took three forms: interpositioning, trading ahead, and failing to execute limit orders.

The Complaint and Settlement Orders, which couple (1) detailed descriptions of sample trades where specialists engaged in interpositioning or trading ahead with (2) generalized allegations concerning the Specialist Firms' knowledge of illegal trading by their employees, are more than sufficient to support a strong inference that the Specialist Firms engaged in interpositioning and trading ahead with scienter throughout the Class Period. *See S.E.C. v. U.S. Envtl., Inc.*, 155 F.3d 107, 111 (2d Cir. 1998) (stating that "knowledge of the proscribed activity is sufficient scienter under § 10(b)") (citing *S.E.C. v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996); *S.E.C. v. Lorin*, 76 F.3d 458, 460 (2d Cir. 1996)). The inference that LaBranche LLC, Spear Leeds LLC, VDM Specialists, Fleet Specialist, and Bear Wagner LLC acted with scienter is further strengthened by the particularized allegations of conscious misbehavior contained in the April, 2005 indictments. Finally, it should be noted that under established principles of agency theory, the specialist firms can be held liable for their agents' Section 10(b) violations if such violations were committed within the scope of the agency relationship. *See, e.g., Vento & Co., LLC v. Metromedia Fiber Network*, 1999 U.S. Dist. LEXIS 3020, No. 97 Civ. 7751 (JGK), 1999 WL 147732, at *12-13 (S.D.N.Y. Mar. 18, 1999) (holding that a plaintiff may rely on agency principles to state a Section 10(b)).

Defendants have also argued that the Plaintiffs have failed to plead that the Affiliated Companies acted with scienter in connection with the alleged manipulative scheme. Plaintiffs argue that they have satisfied this burden merely by stating that the Affiliated Companies "had actual knowledge of the illegal practices and omissions[.]" (Compl. P237.)

Courts of this Circuit have recognized a variety of ways in which to allege that a parent company (or related entity) acted with scienter in connection with a manipulative scheme effectuated by a corporate subsidiary. For example, facts can be alleged that show that the subsidiary's scheme was orchestrated by the parent company. *See, e.g., Carlson v. Xerox Corp.*, 392 F. Supp. 2d 267, 2005 WL 1645960, at *19 (D. Conn. 2005). In addition, the burden can be carried by alleging that the parent company was a party to, or otherwise involved in, the allegedly manipulative transactions. *See, e.g., In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 507 (S.D.N.Y. 2005). Furthermore, scienter can be pled by properly alleging that the parent recklessly disregarded red flags that should have put it on notice of the subsidiary's manipulative scheme. *See, e.g., In re GE Sec. Litig.*, 1995 U.S. Dist. LEXIS 14490, No. 94 Civ. 4024 (JFK), 1995 WL 590639, at *3 (S.D.N.Y. Oct. 4, 1995). No such allegations of these sort have been made with respect to Spear Leeds LP, Goldman Sachs & Co., the Goldman Sachs Group, FleetBoston Corp., Bank of America, Quick & Reilly, Bear Stearns & Co., SIG LLP, or Susquehanna. Rather, the statements contained in paragraph 237 of the complaint are conclusory. Therefore, Count One of the Complaint is dismissed as to these defendants.

However, as discussed in today's companion opinions, it has been properly alleged in related cases that LaBranche & Co., M. LaBranche, and VDM Holding each ignored red flags concerning the improper trading practices of their respective subsidiaries. Since the improper trading practices alleged in the LaBranche and VDM shareholder actions are identical to the alleged improper trading by LaBranche LLC and VDM Specialists at issue

here, for the purpose of this motion, the Court may take judicial notice of the allegations contained in those complaints. *See, e.g., In re Pruitt*, 72 B.R. 436, 440 n.4 (Bankr. E.D.N.Y. 1987) (stating that a court may take judicial notice of the content of its files). On the basis of the allegations asserted in the VDM shareholders' action, it is determined that scienter has been alleged as to VDM Holding from October 18, 2001 until October 15, 2003. Likewise, based on the allegations contained in the LaBranche & Co. shareholders action, it is determined that scienter has been alleged as to M. LaBranche and LaBranche & Co. from August 19, 1999 until October 15, 2003.

3. *Plaintiffs Have Adequately Alleged Loss Causation*

In their separate motions, the Specialist Defendants and the SIG Defendants argue that the Plaintiffs have failed to plead loss causation with adequate particularity. "Loss causation simply 'is the causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff.'" *In re Mutual Funds Inv. Litig.*, 384 F. Supp. 2d 845 (D. Md. 2005) (quoting *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group., Inc.*, 343 F.3d 189, 197 (2d Cir.2003)). In order to adequately allege loss causation, plaintiffs must allege that the defendants' "misrepresentation[s] (or other fraudulent conduct) proximately caused the plaintiff[s'] economic loss." *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627, 1633, 161 L. Ed. 2d 577 (2005).

Rule 8(a)(2), Fed. R. Civ. P., controls the specifics of the required pleading of loss causation, as there is no "special further requirement in respect to the pleading of proximate causation or economic loss." *Id.* at 1634. "So long as Plaintiffs allege a coherent

scheme to defraud the accounts directly for their losses, loss causation has been adequately pled." *In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 375 (S.D.N.Y. 2003).

The Specialist Defendants and the SIG Defendants argue that the Plaintiffs have failed to identify any particular trades in which they suffered loss as a result of the Specialist Firms' alleged manipulative conduct. As stated previously, Plaintiffs are not required to separately allege the elements of their Section 10(b) manipulative scheme claim for each individual transaction. Rather, it is sufficient for a plaintiff to couple specific allegations concerning sample transactions with more general allegations concerning the conduct of the defendant. Here, Plaintiffs have annexed to the Complaint records of stock trades that indicate that during the Class Period, Plaintiffs made scores of trades in 41 of the 42 stocks identified in the Settlement Orders. Given the limitation on the facts that could be expected to be within Plaintiffs' purview, the annexation of these records to the Complaint is sufficient to allege that Plaintiffs participated in transactions in which they paid disadvantageous prices as a result of the Specialist Firms' manipulative conduct. *See, e.g., In re Blech Sec. Litig.*, 928 F. Supp. 1279, 1292 (S.D.N.Y. 1996).

Defendants also argue that the Supreme Court's recent decision in *Dura* that plaintiff's allegation that he paid "an artificially inflated purchase price" inadequate to plead loss causation warrants dismissal. *Dura*, 125 S. Ct. at 1631. While Dura may have relied on the premise that in the typical case "the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent

value," the facts present here do not constitute the typical case. *Id.* (emphasis in original). Here, the ownership of a share does not possess an "equivalent value," *id.*, but rather a value which plaintiffs allege was manipulated by the specialist. (*See* Compl. PP78-80). Plaintiffs allege that it was the specialists' manipulative conduct at the time of the transaction[15] that caused their losses. As such, the "equivalent value," *id.*, of the shares for the purchaser and the seller would have been the price had the specialist performed his function properly. Therefore, the Supreme Court's decision in *Dura* is inapposite, and Plaintiffs have adequately pled loss causation under the unique facts of this case.

4. ***Performance and The SIG Defendants Have Failed To Establish That They Are Insulated As A Matter of Law From Liability For Prior Trades Engaged In By Specialist Firms/Units That They Acquired During The Class Perio***d

a. ***The SIG Defendants***

The SIG Defendants argue that some portion of the improper conduct that they are alleged to have engaged in during the Class Period was actually committed by two specialist firms acquired by SIG Specialists during the Class Period: Corroon Lichenstein & Co., LLC ("Corroon") and Weiskopf Silver Specialists LLC ("Weiskopf"). Furthermore, the SIG Defendants allege that some portion of the conduct identified in the Settlement Orders was

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[15] Plaintiffs allege that Defendants, rather than matching orders as they should have, purchased shares from sellers at a manipulated lower price, only to turn around an sell shares to a purchaser at a manipulated higher price, locking in a guaranteed riskless profit.

committed prior to the dates that these two firms were acquired. Corroon was apparently acquired in March 2000 and Weiskopf was apparently acquired in July 2001.

The SIG Defendants appear to argue that as a matter of general federal common law, the purchaser of a corporation's assets does not, as a result of the purchase, ordinarily become liable for the seller's debts. On this basis, the SIG Defendants argue that this Court must dismiss the Section 10(b) claim against them to the extent that it is based on conduct engaged in by Corroon and Weiskopf prior to their acquisition by SIG Specialists.

This argument fails for two reasons. First, successor liability is typically governed not by general federal common law, but rather by the law of the state whose law applies to the interpretation and enforcement of a merger agreement. *See, e.g., Cargo Partner AG v. Albatrans, Inc.*, 352 F.3d 41, 45 (2d Cir. 2003) (applying New York rule concerning successor liability); *Nettis v. Levitt*, 241 F.3d 186, 193 (2d Cir. 2001) (observing that no conflict existed between New York and New Jersey law with respect to the imposition of successor liability). Here, the SIG Defendants have failed to indicate what state's law governed the enforcement of the terms of SIG Specialists' acquisition of Corroon and Weiskopf. Under such circumstances, it is impossible to determine as a matter of law that the SIG Defendants cannot be held liable for conduct by Corroon and Weiskopf that predated their acquisition by SIG Defendants.

Furthermore, the above-described general rule concerning successor liability is subject to well-recognized exceptions. For example, pursuant to the

law of New York and New Jersey, "when a successor firm acquires substantially all of the predecessor's assets and carries on substantially all of the predecessor's operations, the successor may be held to have assumed its predecessor's tort liabilities, notwithstanding the traditional rule that a purchaser of corporate assets does not assume the seller's liabilities." *Nettis*, 241 F.3d at 193. Other well-recognized exceptions to the above-described general rule of a non-liability include: (1) "where the purchaser either expressly or implicitly has agreed to assume some or all of the debts and liabilities of the seller"; (2) "where there is a continuity of ownership or corporate structure between the selling corporation and the buying corporation"; and (3) "where a transaction is entered into fraudulently in order to evade liability for debts." David W. Pollak, *Successor Liability in Asset Acquisitions, in* 2 PLI Course Handbook, Acquiring or Selling the Privately Held Company 2002, at 271-75 (2003) (collecting cases).

As suggested by the above-described exceptions, the analysis of whether a defendant can be held liable for a predecessor's obligations, whether such obligations arise in tort or contract, is fact-intensive. Therefore, at this stage of the litigation, it is appropriate to deny the SIG Defendants' motion with respect to conduct alleged to have been committed by Corroon and Weiskopf prior to their acquisition by SIG Specialists. Finally, it should be noted that while the SIG Defendants argue that some of the illegal activity alleged in the Complaint may have occurred before SIG Specialists acquired Corroon and Weiskopf, they do not dispute that other of the conduct was committed by SIG Specialists during the Class Period.

b. ***Performance***

Similar to the SIG Defendants, Performance has argued that it was formed as a result of its acquisition in October 1999 of the assets of two specialist units. Performance argues that it is the smallest NYSE specialists firm and that the volume of trading affected by its allegedly improper conduct was extremely small. Moreover, Performance argues that it is not liable for alleged violations committed by other specialists before it acquired their assets. As discussed above, there are significant issues of fact that preclude this Court from determining, as a matter of law, that Performance is insulated from liability with respect to the pre-acquisition conduct of its business units. That is, this issue cannot be properly resolved without the development of a record concerning: (1) which state's law should apply to the question of Performance's successor liability, and (2) whether under that state's law, the particular facts and circumstances of Performance's acquisitions would render it liable for their pre-acquisition conduct.

E. ***Plaintiffs Adequately State A Section 10(b) Claim Based on Defendants' Allegedly False And Misleading Statements***

Plaintiffs have alleged that certain of the Specialist Firms, as well as LaBranche & Co., M. LaBranche, and SIG LLP made false and misleading statements in violation of Section 10(b). As stated previously, the elements of a Section 10(b) misrepresentation claim are that the defendant "(1) made misstatements or omissions of material fact; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiff[] relied; and (5) that plaintiff['s] reliance was the proximate cause of [the] injury." *In*

re Livent, Inc. Sec. Litig., 78 F. Supp. 2d at 213. Defendants argue that dismissal of Plaintiffs' misrepresentation claim is warranted because: (1) the statements at issue merely reiterate the duty that Defendants are alleged to have breached through the operation of the manipulative scheme described in the Complaint, and (2) the Plaintiffs have failed to adequately plead reliance on the statements at issue. Plaintiffs argue that the statements at issue do more than merely reiterate a specialists' obligations and that they are entitled to a presumption of reliance based on the fraud-on-the-market theory.

With respect to Defendants' first contention, as the Federal Rules of Civil Procedure permit the pleading of claims in the alternative, *see* Fed. R. Civ. P. 8(e)(2), Plaintiffs are not precluded from pleading a manipulative scheme claim and a misrepresentation claim based upon the same underlying conduct. Therefore, assuming arguendo Plaintiffs manipulative scheme claim and misrepresentation claim are based upon a breach of the same underlying duty, dismissal on such grounds would be improper at this stage. To the extent that discovery reveals that the two claims overlap and the law prohibits this, Defendants may move for dismissal at the appropriate stage of this litigation.

With respect to Defendants' second argument, the general rule with respect to securities fraud claims is that in order to plead reliance, the plaintiff must specifically allege direct reliance upon the defendant's misrepresentation or omission. *See, e.g., Clark v. Nevis Capital Mgmt., LLC*, 2005 U.S. Dist. LEXIS 3158, No. 04 Civ. 2702 (RWS), 2005 WL 488641, at *18 (S.D.N.Y. Mar. 2, 2005). However, under proper

circumstances, a plaintiff may rely on the fraud-on-the-market doctrine in order to plead reliance. As stated by the Second Circuit:

> The fraud-on-the-market doctrine, as described by the Supreme Court in *Basic v. Levinson,* creates a rebuttable presumption that (1) misrepresentations by an issuer affect the price of securities traded in the open market, and (2) investors rely on the market price of securities as an accurate measure of their intrinsic value. *See Basic*, 485 U.S. 224, 245-47, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988); *accord, e.g., In re Ames Dep't Stores Inc. Stock Litig.*, 991 F.2d 953, 967 (2d Cir. 1993). This presumption, if unrebutted, thus allows plaintiffs to satisfy the element of reliance in securities fraud claims under the 1934 Act . . . . The doctrine "arose as a practical response to the difficulties of proving direct reliance in the context of modern securities markets, where impersonal trading rather than a face-to-face transaction is the norm." [*In re WorldCom, Inc. Sec. Litig.*, 219 F.R.D. 267, 291 (S.D.N.Y. 2003).] Although the fraud-on-the-market doctrine clearly applies to statements made by *issuers,* as in *Basic,* we have never addressed whether it also applies to reports by analysts.

Hevesi v. Citigroup Inc., 366 F.3d 70, 77 (2d Cir. 2004). As stated by a leading commentator, the rationale underlying the fraud-on-the-market doctrine is that:

> the integrity of the securities markets is premised on the dissemination of accurate information about companies and their securities. When misleading information is injected into the market, it can move securities

> prices in an artificial manner . . . . When the pricing mechanisms are rendered inaccurate because of material misinformation, something that is tantamount to a fraud has taken place.

Thomas Lee Hazen, Law of Securities Regulation § 12.10[6][A] (Fraud on the Market Defined) (5th ed. 2005).

Here, Plaintiffs allege that the Specialist Defendants made misrepresentations and misstatements concerning not specific securities, but rather the marketplace for those securities. The Complaint alleges, in essence, that the Specialist Defendants made false and misleading statements concerning (1) the extent of their efforts to minimize the transaction costs paid by their customers in connection with the purchase or sale of an otherwise efficiently priced security, and (2) the extent to which stocks were bought and sold at market prices, as opposed to artificially high and low prices.

The fraud-on-the-market doctrine is applicable to misstatements about specific securities as well as misstatements about the marketplace for those securities. *See In re Blech Sec. Litig.*, 961 F. Supp. 569 at 587. As in *Blech,* Plaintiffs allege that the Specialist Defendants' false and misleading statements were "in the context of market manipulation." *Id.* at 587. The reliance upon which Plaintiffs' claims rest was the honesty and integrity of the NYSE.

As noted, the fraud-on-the-market doctrine is premised on the understanding that the dissemination of misleading information about a given security will move the price of that security in an artificial manner. Just as information about a specific security is reflected in the price of that security, so too is

information about the manner in which transactions would be completed reflected in the price of securities generally. Plaintiffs may be presumed to have relied upon information indicating that securities would be matched by specialists, as opposed to bought and sold at artificially high and low prices.[16]

Accordingly, Plaintiff's allegations fall within the fraud-on-the-market doctrine and reliance upon the alleged misrepresentations is presumed.

E. *Plaintiffs Have Stated A Section 20(a) Claim Against All Specialist Defendants Except Susquehanna*

Count Two of the Complaint alleges that the Defendants are liable for controlling persons culpable of violating *section 10(b)* in violation *Section 20(a)* of the Exchange Act. *Section 20(a)* provides as follows:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable . . . to the same extent as such controlled person . . . unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a).

In order to plead control person liability under Section 20(a), a plaintiff must "allege a primary § 10(b) violation by a person controlled by the

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[16] For example, to the extent that a given specialist defendant was the specialist of a given stock, the information they disseminated was incorporated into the total mix of information about that given stock upon which investors are presumed to have relied under the fraud-on-the-market exception.

defendant and culpable participation by the defendant in the perpetration of the fraud. *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001) (holding that plaintiffs had stated a Section 20(a) claim against defendant bank where it was alleged that: (1) the person who had committed the alleged violation of Section 10(b) was an officer of the bank, and (2) the officer was responsible for the bank's relationship with a venture whose securities were the subject of the alleged Section 10(b) violation).

Here, it is alleged that the each of the Defendants acted as a controlling person within the meaning of Section 20(a). The Specialist Defendants[17] argue that no control person liability can arise here because no claim for a primary violation of Section 10(b) has been stated. Since it has been determined that the Plaintiffs have stated a *Section 10(b)* manipulative scheme claim against the Specialist Firms, LaBranche & Co., M. LaBranche and VDM Holding, this argument fails. Moreover, The Specialist Defendants have asserted no other basis for dismissal of Plaintiffs' Section 20(a) claim.

Courts of this district have indicated that a person is either a "control person" or a "primary violator" under section 20(a), but cannot be both. *See Kalnit v. Eichler*, 85 F. Supp. 2d 232 (S.D.N.Y. 1999), *aff'd* 264 F.3d 131 (2d Cir. 2001). In *Kalnit,* the plaintiff sought to hold the individual directors of a corporate defendant liable as control persons for misrepresentations and omissions that they themselves were alleged to have made. *See id.* at 245. In order to

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[17] As set forth above, under the facts alleged by the Plaintiffs, NYSE has absolute immunity from control person liability.

establish liability under Section 20(a) as to the individual defendants in that case, the plaintiff necessarily would have had to establish those very defendants' liability as primary violators. *See id.* The court concluded, therefore, that, "under plaintiff's own theory, the Directors could not be control persons and section 20(a) does not apply." *Id.*

The logical inconsistency that required dismissal of the Section 20(a) claim in *Kalnit* is not present here, where multiple manipulative schemes are alleged to have been effectuated by various of the Specialist Defendants. It is conceivable that one defendant ultimately might be found to be a primary violator while another defendant might be found to be a control person under Section 20(a). As the Federal Rules of Civil Procedure permit the pleading of claims in the alternative, *see* Fed. R. Civ. P. 8(e)(2), Plaintiffs are not precluded from pleading that the Defendants are both primary violators and control persons.

Based on the foregoing, it is determined that Plaintiffs have stated a Section 20(a) claim against the Specialist Defendants.

Finally, the SIG Defendants argue that Plaintiffs have failed to plead with requisite particularity that SIG LLP and Susquehanna exercised control over SIG Specialists and that these two entities had culpable participation in the alleged Section 10(b) violations. This court has previously indicated that the culpable participation element of the Section 20(a) claim is subject to the PSLRA's heightened pleading requirements. *See In re Regeneron Pharms., Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 1350, No. 03 Civ. 3111, 2005 WL 225288, at *11, n.4 (S.D.N.Y. Feb. 1, 2005). However, the Court is now of the view

that in order to state a Section 20(a) claim, no such particularized allegations are required. *See In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 392, 415 (S.D.N.Y. 2003) (stating that "the concept of culpable participation describes that degree of control which is sufficient to render a person liable under Section 20(a). At the pleading stage, the extent to which the control must be alleged will be governed by Rule 8's pleading standard.") Here, Plaintiffs have alleged that SIG Specialists is a wholly-owned subsidiary of SIG LLP and that Susquehanna is SIG LLP's institutional brokerage affiliate. In support of this allegation, Plaintiffs point out that SIG LLP's website states that it is "comprised of several trading and investment related entities under common control, including SIG Specialists, Inc." (Compl. P19(j).) Pursuant to the Second Circuit's holding in *Suez,* these allegations are sufficient to state a Section 20(a) claim against SIG LLP.

However, there are no such allegations concerning Susquehanna's control over SIG Specialists. Rather, the Complaint merely alleges that Susquehanna: (1) is SIG LLP's international brokerage affiliate, (2) and is affiliated with SIG Specialists. Therefore, Plaintiffs' 20(a) claim with respect to Susquehanna must be dismissed for failure to state a claim.

F. ***Plaintiffs' Motion To Modify The PSLRA Discovery Stay Is Denied As Moot***

On October 1, 2004, Plaintiffs moved to modify the PSLRA discovery stay, which provides that "in any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve

evidence or to prevent undue prejudice to that party." 15 U.S.C. § 78u-4(b) (3) (B).

In light of the disposition of the present motions, this motion to modify the discovery stay is denied as moot. Discovery in this case will now proceed.

Conclusion

Based on the foregoing, it is determined that the Complaint is dismissed with prejudice in its entirety as to NYSE.

The motion to dismiss the Section 10(b) manipulative scheme claim is denied with respect to the Specialist Firms, LaBranche & Co. (for the period August 19, 1999 to October 15, 2003), M. LaBranche (for the period August 19, 1999 to October 15, 2003), and VDM Holding (for the period October 18, 2001 to October 15, 2003). The *Section 10(b)* manipulative scheme claim is dismissed as to all other Affiliated Companies.

The motions to dismiss the Section 10(b) false and misleading statement claims are denied.

The Section 20(a) claim is dismissed as to Susquehanna. The motion to dismiss the Section 20(a) claim is otherwise denied.

The state law breach of fiduciary duty claims are dismissed with prejudice as to all defendants.

To the extent that claims have not been dismissed with prejudice, leave is granted to replead within thirty (30) days of entry of this Opinion.

It is so ordered.

New York, NY

December 12, 2005

ROBERT W. SWEET

U.S.D.J.

Appendix 1

NYSE Statements Alleged To Be False and Misleading

Plaintiffs allege that the following NYSE statements made during the Class Period are false and misleading.

1. *NYSE Advertisement (featuring testimonial statement by Berkshire Hathaway Inc. CEO Warren E. Buffet)*

Plaintiffs allege the following testimonial statements, which appeared in an advertisement published by NYSE after Berkshire Hathaway, Inc. listed its shares on the NYSE, was false and misleading:

> "Berkshire Hathaway listed on the NYSE to reduce shareholder transaction costs. When we switched from OTC to the NYSE, we had high expectations of reducing our transaction costs. Those expectations have been exceeded. A much narrower spread has prevailed on the NYSE than in the over-the-counter market, and we couldn't be more pleased. We wanted the best market we could obtain for our shareholders. The NYSE is that market." [(Testimonial statement by Berkshire Hathaway, Inc. CEO Warren E. Buffet)]

> The most liquidity. The highest visibility. The fairest pricing. The broadest access to the greatest number of investors. Just a few of the reasons why so many outstanding companies list their shares on the NYSE.

(Compl. P140.)

2. *NYSE Advertisement (featuring testimonial statements by Vivendi Chairman and CEO Jean-Marie Messier)*

Plaintiffs allege the following testimonial statement by Vivendi Chairman and CEO Jean-Marie Messier, which appeared in an advertisement published by NYSE after Vivendi listed its American depository shares on the NYSE in September 2000, was false and misleading: "Our New York Stock Exchange listing supports the achievement of this objective by giving our shares visibility, credibility, and security in the crucial U.S. capital markets and all around the world." (Compl. P141.)

3. *December 20, 2002 Statement by NYSE CEO Richard Grasso*

Plaintiffs allege that the following statement by NYSE CEO Richard Grasso ("Grasso"), which is alleged to have been made on December 20, 2002 on the television program *Nightly Business Report,* was false and misleading:

> The American public, some 85 million investors strong, don't expect the guarantee of a profit when they enter risk-taking in our capitalist system. What they expect, and what we should absolutely be in a position to deliver always, is a guarantee that their interests will be

> held first and primary to the interests of those in the intermediation business.

Nightly Business Report (Community Televison Foundation of South Florida, Inc., Dec. 20, 2002).

4. *NYSE Brochure ("A Guide To The World's Leading Security Market")*

Plaintiffs allege that the following statements from the NYSE brochure entitled "A Guide To The World's Leading Securities Markets" was false and misleading:

> The NYSE provides an efficient, fair, and secure marketplace for investors to trade shares of stock. The NYSE's auction market enables investors to get the best price at the time of the transaction. The auction market represents price improvement at the point of sale, narrow spreads, and accountability to investors through extensive surveillance, ensuring a fair trading environment.
>
> * * *
>
> NYSE Market Surveillance investigates unusual trading situations. These cases don't include only insider trading, but also violations of auction market procedures, instances when price changes in stocks seem too wide, frontrunning (when a firm trades a stock in advance of issuing a research report), books and records violations, and other violations of rules governing members' on-floor trading.

(Compl. P143.)

5. January 18, 2001 Press Release

Plaintiffs allege that the following statement contained in a January 8, 2001 NYSE press release was false and misleading: "Our agency-auction model joins the greatest liquidity and transparency with the most efficient method of price discovery, leading to the lowest execution costs and best prices for customers." (Press Release, NYSE, NYSE Media Statement re: SEC Report on the Comparison of Order Executions Across Equity Market Structures (Jan. 8, 2001) (*available at* www.nyse.com/audience/media.html).)

6. Statement On How NYSE Listing Benefit Non-U.S. Companies

Plaintiffs alleged that the following statement, which appears on the NYSE website, is false and misleading:

> In addition to providing access to the world's largest pool of investors, an NYSE listing provides public companies with the world's most efficient, competitive and equitable marketplace for the trading of their shares. The unmatched quality of the NYSE auction market—the broadest range of investors, the greatest liquidity, the most visibility, the most efficient and cost-effecting capital-raising process—are often cited as the most compelling reasons to list. Listing on the NYSE also enhances a company's reputation globally, not only among investors but all of its constituents. An Exchange listing also provides the currency for future strategic acquisitions in the U.S.

(NYSE, Information for Listing on the NYSE, *available at* www.nyse.com/audience/listingonthenyse.html (last visited Sept. 14, 2005).)

7. September 28, 1999 Senate Testimony By Grasso

Plaintiffs allege that the following testimony by Grasso, which was given before the Senate Banking Committee, was false and misleading: "Over the years, the NYSE has served investors well by providing a highly liquid, efficient, and transparent market, with a system of self-regulation that is second to none." (*09/28/99 Hearing On Public Ownership of the U.S. Stock Markets Before The Senate Banking Comm.*, 1999 WL 766067 (prepared testimony of Richard A. Grasso, NYSE Chairman and CEO).)

8. NYSE 2002 Annual Report

Plaintiffs allege that the following statements from NYSE's 2002 annual report were false and misleading:

> Before committing their trust and savings to the market, investors must be guaranteed a fair and level playing field along with equal access to information and guidance they can trust. They require certainty that those entrusted with protecting their interests will do so faithfully—with complete integrity and without compromise. And the people and practices responsible for the crisis of confidence must be thoroughly and permanently rooted out.
>
> * * *
>
> The Exchange's investment in technology has exceeded $2 billion during the past decade. As a result, the NYSE is the world's most technologically advanced equities market, and

the most reliable and cost-efficient venue for the trading of equities.

* * *

A total commitment to market quality, innovation and our customers . . . While corporate accountability and investor protection took center stage, it did not distract the NYSE from its obligation to provide investors and all market participants with the highest levels of market quality, service and support. Our commitment to continuous innovation and advanced technology produces unparalleled reliability, cost efficiency and productivity. Once again, the Exchange has been recognized as the world's low-cost market for trading services as well as the most liquid and transparent. As a result, ours was the only major U.S. equities market to experience an increase in average daily trading volume—to 1.44 billion shares a day, more than double the daily volume of just five years ago.

To accommodate this growing demand, the Exchange increased data processing capacity by 50%, which boosts available trading capacity to more than five times average daily volume. And with extensive system redundancy and off-site contingency centers in place, our customers can rest assured that the NYSE is well prepared to meet their demanding and complex needs, regardless of circumstance.

(2002 NYSE Annual Report at 2, 4, *available at* www.nyse.com/about.)

9. *February 13, 2002 NYSE Press Release*

Plaintiffs allege that the following statements by Grasso in NYSE's February 13, 2002 press release were false and misleading:

> It is imperative that we reinforce trust and confidence in our publicly traded companies and in our markets . . . . []Investors demand and deserve nothing less than timely and accurate disclosure, sound corporate governance, and an established set of practices that ensure transparency and integrity. This is in the best interests of investors, issuers and the markets.
>
> []Are there steps that should be taken to build additional safeguards for investors? [] . . . []The issues to date have been company-specific, not systemic; but we need to step back and ask what must we do to restore the public's faith. Despite recent failures, our economic system is the most admired in the world and largely driven by investor confidence and public participation. More than 85 million Americans are shareholders. They are not asking for guaranteed profits; they are asking for and deserve guaranteed transparency and a level playing field. []

(Press Release, NYSE, NYSE Appoints Special Board Committee To Advise on Corporate Governance: NYSE Corporate Accountability and Listing Standards Committee (Feb. 13, 2001) (*available at* www.nyse.com/audience/media.html)).

10. *April 25, 2002 Statement By Grasso*

Plaintiffs allege that the following statement by Grasso, issued April 25, 2002, was false and

misleading: "There is no room in financial markets, nor in financial intermediaries, for those who would put their own interests ahead of those of their customers." (Press Release, NYSE, Statement from NYSE Chairman and CEO Dick Grasso (Apr. 25, 2002) (*available at* www.nyse.com/audience/media.html).)

11. *Statements From NYSE Newsletters*

Plaintiffs allege that the following three statements, which appeared in the NYSE newletter, were false and misleading:

> Investors already get the best prices at the NYSE. The challenge is to make the process that delivers those prices increasingly efficient.
>
> * * *
>
> Investors are entitled to the best possible price no matter where their orders originate or are executed. This is a challenge for the entire industry. Our collective goal must be to never forget who we serve: the investor.
>
> * * *
>
> Protecting investors is the NYSE's highest priority . . . . Through aggressive surveillance and enforcement of our rules and the federal securities laws, our staff works to prevent any individual or firm from betraying our customers' trust and vigorously seeks out and punishes those who do.

(NYSE November 1999 Newsletter (Compl. P150); NYSE December 1999 Newsletter (Compl. P151); Dick Grasso, *The Heart of the Matter*, The Exchange (NYSE, New York, N.Y.), May 2003, at 1. (*available at* http://www.nyse.com/about/publication) [1].)

1 NYSE's online archive of newsletters spans from January 2003 to the present.

12. *NYSE Statement Concerning The Role Of The Specialist*

Plaintiffs allege that the following statements by the NYSE concerning the role and obligations of the specialist were false and misleading:

> **The Specialist**
>
> A key feature of the NYSE auction market is the role of the assigned dealer, generally known as the specialist. Specialists are required to perform several specific functions:
>
> . They maintain current bid and asked prices for their assigned stocks. This information is transmitted worldwide, keeping all market participants informed of the total supply and demand for any NYSE-listed stock.
>
> . They act as agents, executing orders entrusted to them by a trading floor broker, such as the limit order . . . .
>
> . When there is a temporary shortage of either buyers or sellers, specialists will buy or sell for their own accounts, against the trend of the market. In recent years, 88 percent or better of specialist trades have been counter to the market trend, helping to balance the immediate supply and demand for a stock. Such activity is not typical of most other markets . . . .
>
> . They act as catalysts, bringing buyers and sellers together, so that offers to buy can be matched with offers to sell. The absolute obligation of the specialists is to place and

execute public investor orders ahead of their own—to yield at all times to public orders.

* * *

In recent years, the NYSE has adopted important new measures to assure the continued integrity and competitiveness of its marketplace . . . . Recognizing the imperative of increasing this participation, the NYSE, together with other exchanges and the Securities and Exchange Commission, as addressed specific investor concerns about owning stocks in today's complex investment environment. This includes the rules and regulations necessary to impose some practical limits on volatile price movements within a trading session. It also includes better access to the market in times of unusual activity.

To handle increased volume, the NYSE has strengthened its professional and technological resources. In addition, the flow of information available to investors has been steadily improved, and electronic technology now makes it possible to receive orders, execute trades and report back to investors in less than 30 seconds, a time frame unheard of 10 years ago. New human and technological resources have been devoted, as well, to surveillance and enforcement activities, ensuring that the NYSE market remains the fairest and most open in the world.

(Compl. P153.)

Appendix 2

Statements By Specialist Defendants Alleged To Be False and Misleading

1. ***LaBranche LLC***

The Complaint alleged that the following statements by LaBranche LLC were false and misleading:

> When assigned a particular stock, the specialist firm agrees to specific obligations. The specialist firm's role is to maintain, as far as practicable, trading in the stock that will be fair and orderly. This implies that the trading will have reasonable depth and price continuity, so that, under normal circumstances, a customer may buy or sell stock in a manner consistent with market conditions. A specialist firm helps market participants achieve price improvement in their trades because the best bids and offers are discovered through the auction process.

(Compl. P162.)

> [A] specialist has a duty to maintain, as far as practicable, a fair and orderly market in its specialist stocks. In order to fulfill its obligations, the specialist must at times trade for its own account, even when it may adversely affect the specialist's profitability. In addition, under some circumstances, the specialist is prohibited from making trades as principal in its specialist stocks. The specialist's obligations are briefly described below.
>
> Requirement to Trade as Principal. A specialist must buy and sell securities as principal when necessary to minimize an actual or reasonably anticipated shortterm imbalance between supply and demand in the auction market. The specialist must effect these transactions when their absence could result in an unreasonable lack of continuity and/or depth

in their specialist stocks. The specialist is not expected to act as a barrier in a rising market or a support in a falling market, but must use its own judgment to try to keep such price increases and declines equitable and consistent with market conditions.

A specialist must make firm and continuous two-sided quotations that are timely and that accurately reflect market conditions. In making these quotations, the specialist's transactions are calculated to contribute to the maintenance of price continuity with reasonable depth. Following is an illustration of how a specialist acts as principal to maintain price continuity . . .

* * *

Trading Restrictions. In trading for its own account, the specialist must avoid initiating a market-destabilizing transaction. All purchases and sales must be reasonably necessary to permit the specialist to maintain, as far as practicable, a fair and orderly market in its specialist stocks. In addition, the specialist must comply with the following trading requirements:

A specialist must first satisfy a customer's market buy order (an order to buy at the prevailing market price) before buying any stock for its own account. Similarly, a specialist must first satisfy a customer's market sell order (an order to sell at the prevailing market price) before selling any stock for its own account.

A specialist must first satisfy a customer's limit order held by it before buying or selling at the same price for its own account. A limit order is an order either to buy only at or below a

specified price, or to sell only at or above a specified price. A specialist may not have priority over any customer's limit order. A specialist, however, may buy or sell at the same price as a customer limit order as long as that limit order is executed first.

If a public buyer wants to buy at a particular price and a seller wants to sell at the same price, the buyer and seller trade directly with each other, and the specialist should not interfere in the transaction.

The specialist does not charge commissions for trades in which it acts as a principal.

Except in some circumstances in less active markets, the specialist may not, without permission from an NYSE official, initiate destabilizing trades for its own account which cause the stock price to rise or fall.

Any transactions by the specialist for its own account must be effected in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular stock and the adequacy of the specialist's position to the immediate and reasonably anticipated needs of the market.

(Compl. P168; 06/18/99 Form S-1 Registration Statement, at 41, 42; 03/30/00 Form 10-K, at 9-10; 03/30/01 Form 10-K, at 13-15; 03/15/02 Form 10-K, at 13-15.)

As a NYSE Specialist, LaBranche plays an essential role in the auction market system. We act as agent, auctioneer, catalyst and principal. From its posts on the floor of the NYSE, the firm

> takes a proactive role in bringing together buyers and sellers, all the while fulfilling its obligation to maintain fair and orderly markets in the stocks it trades.

(*Id.* P169; LaBranche & Co., 2000 Annual Report 4-5 (2001).)

> Against a backdrop of an economy in recession and a substantial downward adjustment in the valuation of world equity markets, we remained solidly profitable while providing customers with the most transparent, fair and liquid markets anywhere.
>
> * * *
>
> As Specialist, we hold a unique position in the auction market system, bringing together buyers and sellers and meeting our obligation to maintain fair and orderly markets in the stocks we trade.

(*Id.* P170; LaBranche & Co., 2001 Annual Report 1,5 (2002).)

> "The march of technological change has enabled us to consistently improve the quality of execution—which means faster, lower-cost transactions with greater price transparency—and to bring the investor ever closer to the point of sale."
>
> * * *
>
> For us, technology is an essential tool in helping us fulfill one of our fundamental missions: to continually improve the quality of transaction execution.

* * *

> LaBranche engaged in numerous initiatives designed . . . to lead the way in helping to create market environments that deliver superior execution to the investing community.

(*Id.* P171; LaBranche & Co., 2002 Annual Report 2,8,11 (2003) (quoting M. LaBranche).)

> LaBranche is committed to providing the most efficient stock executions utilizing cutting-edge technology. We are supportive of initiatives that enable the Specialist to execute with greater certainty when best price is still attained as a result. It is our goal to enhance the capability of our customers to access the vast pools of liquidity in our markets. In the long run, market quality and the cost of execution will determine the most successful market structure. We believe that our auction market, with the Specialist playing an important role, will continue to be the best market in the future. We believe that LaBranche is well positioned to benefit from the many changes taking place and, as always, will work to best maximize your investment.

* * *

> The Specialists of LaBranche play a pivotal role in the functioning of the auction market that is at the heart of the NYSE. The auction market structure, which distinguishes the NYSE from other major equity markets, is considered among the world's most efficient market environments. At the NYSE, the auction market allows all participants, whether large or small, to interact in the marketplace in a fair way. The LaBranche Specialist is charged with maintaining fair,

> competitive and orderly trading. Combining human judgment, our firm's own capital, and advanced technology, our Specialists help create a trading environment that has become the most successful equity marketplace in the world.

(*Id.* P172; LaBranche & Co., 2003 Annual Report 3,4 (2004))

> "LaBranche & Co fully recognizes and understands its role as the largest Specialist firm at the NYSE. In that regard, LaBranche & Co. has always held itself and its specialists to the highest standards. Our specialists have always focused on putting its customers first, as proven by the superior price improvement that our specialists provide to our customers on a daily basis. LaBranche & Co. has always been committed to the regulatory framework of the NYSE and has responded promptly to any area of regulatory concern."

(*Id.* P173; Press Release, LaBranche & Co., LaBranche & Co. Issues Statement Regarding Wall Street Journal Article (Apr. 17, 2003) (quoting M. LaBranche).)

> "We work diligently to make sure our customers are getting the best prices available. . . . It is our priority to make sure their interests are protected."

(*Id.* P174; Philip Boroff, *Specialist Firms Scrutinized By NYSE,* Wash. Post, Apr. 18, 2003, at E2 (quoting M. LaBranche).)

2. *LaBranche & Co. And NYSE*

The Complaint alleges that the following statements are attributable to both LaBranche & Co and NYSE:

> Good morning, I am Bob Murphy, New York Stock Exchange specialist with LaBranche & Company as well as New York Stock Exchange Director and Vice Chairman of the board. . . . Specialists on the New York Stock Exchange are accountable to the investing public, for the quality of NYSE markets and their specialty stocks. This means that the specialist is responsible for fostering and maintaining liquidity and continuing two-sided auction markets on the NYSE floor. The specialist plays a pivotal role in insuring that investor orders receive the best possible execution. To accomplish this, specialists act both as agent and principal in their specialty stocks, to help insure that markets for those stocks are fair and orderly, and that they operate efficiently in the public interest. The NYSE specialist is the focal point of the auction price discovery process. The specialist's primary job is to bring buyers and sellers together in an efficient and orderly manner to provide transparency and liquidity and to maximize the opportunity for public buy and sell orders to interact without getting between them.
>
> The NYSE specialist has an affirmative obligation to step in and step up when no one else wants to. The specialist buys or sells as principal when necessary to minimize short-term imbalances between supply and demand. In this way, the specialist provides depth and price

continuity, minimizes volume at this time in the auction market. In addition, the specialist has a negative obligation. The specialist may not trade for a proprietary account unless reasonably necessary to maintain a fair and orderly market.

* * *

The industry has changed quite a bit since I first came to Wall Street and not all for the better. I am concerned about a number of anticustomer practices that I see in the industry today. Dealers in other markets cherry pick the easiest orders of the least informed customers and execute those orders at prices discovered at the NYSE while NYSE specialists stand ready to accept all orders of all customers, including the offsetting orders of the cherry pickers. Agents for customers receive payment for their customer orders. Agents for customers trade against orders for their customers, without giving those orders a chance to interact with other orders of public customers. Dealers in other markets disseminate non-competitive quotes, thereby shunning the responsibility to make markets for all, while still guaranteeing significant order flow.

An exchange buys reports of off-exchange trades from OTC dealers and ECNs and fraudulently prints those off exchange trades as though they have actually taken place on that exchange. An ECN hides quotes and its participants ignore better priced orders on other markets.

Regaining investor confidence is crucial to the continued preeminence of our secondary markets, yet we have allowed to creep into our

markets practices in which dealers and even agents put their own interests ahead of the interests of their customers. The NYSE trading model precludes these anti-investor practices by the very way that it has evolved. We integrate the trading of institutional and retail orders into a single auction and we apply automation to the extent consistent with that integration. This provides investors with optimal price discovery and maximum flexibility. Other markets take different approaches, but whatever model a market may choose, the Commission should not permit it to embody those anti-investor practices—and that requires the Commission to attack the root causes of those practices.

* * *

We believe Congress got it right in 1975 when it determined that transparency was the heart of effective inter-market competition and when it bounded intermarket competition by the principle that dealers should only intervene as a last resort, thus, we support all markets disseminating as much as is possible, trading interests disclosed at the point of sale. We support maximizing the opportunities for customer orders to interact directly within a market so that the particular participants to a trade receive best execution and all market participants receive the benefits of optimal price discovery.

Let's place the customer first . . . .

(Compl. PP177-79 (quoting Murphy at Nov. 12, 2002 SEC Hearing).)

3. *Spear Leeds LLC*

Plaintiffs have alleged that the following statements by Spear Leeds LLC are false and misleading:

> **What is the role of a Specialist?**
>
> Specialists are responsible for maintaining a liquid and continuous two-sided auction market by acting as both an agent and a principal. Specialists ensure that markets are fair, orderly and competitive..
>
> **What are the primary responsibilities of a Specialist?**
>
> Specialists are required to make continuous two-sided quotations that accurately reflect prevailing market conditions. In performing this function, Specialists can act as both an agent and a principal.
>
> When acting as agent, Specialists match the orders of buyers and sellers, thus ensuring timely execution at the best available price. Specialists have a Negative Obligation to provide an opportunity for public orders to be executed against each other without undue intervention.
>
> Occasionally, it's not possible to match buy and sell orders due to a short term imbalance between supply and demand for a company's shares. Under those circumstances, Specialists will act as principal.
>
> When acting as principal, Specialists have an Affirmative Obligation to buy and sell securities in order to maintain price continuity with reasonable market depth . . . .

(Compl. P155.)

> Since 1931, Spear, Leeds & Kellogg Specialists LLC has been committed to this simple, yet vital principle.
>
> As of April 30, 2005, SLKS proudly serves as specialist for 558 NYSE-listed companies. Our portfolio is comprised of the most prestigious domestic and international companies, built one relationship at a time. SLKS clients benefit from our high standard of trading excellence, our significant capital position and our unique relationship with our parent, Goldman Sachs Group.
>
> At SLKS, we are committed to building meaningful relations based upon mutual respect and trust, to providing our clients with comprehensive, relevant, useful information, and to making fair, orderly and liquid markets.

(Spear Leeds LLC, *Our Clients Always Come First, available at* http://www.slk.com (last visited Sept. 14, 2005).)

> Integrity and honesty are at the heart of our business. We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives.

(Spear Leeds LLC, *Our Business Principals, available at* http://www.slk.com (last visited Sept. 14, 2005).)

4. *VDM Specialists*

The Complaint attributes no false or misleading statements to VDM Specialists.

5. *Fleet Specialist*

Plaintiffs have alleged that the following statements by Fleet Specialist were false and misleading:

> All customers, whether individual or institutional, must have an equal opportunity to interact and receive the best price. This premise is at the heart of an auction market and at the heart of the specialist's role. Our specialists focus on cushioning volatility. They act like shock absorbers to ensure trade-to-trade price continuity in either direction. A specialist sells on the upswing and buys on the downturn in order to create a fair, competitive, orderly and efficient market for the protection of shareholders.
>
> * * *
>
> The specialist is also the agent representing all SuperDot (electronically routed) orders and for investors who place orders with brokers specifying price limits at which they are willing to trade. . . .

(Compl. P159.)

> A member of the stock exchange charged with maintaining fair and orderly markets, providing liquidity and stability to the securities he is assigned. Primary among the specialist's responsibilities are a) maintaining the published quote, b) acting as agent for customers' orders, c) as principal, buying or selling for his own account against the market trend and d) acting as a catalyst, providing accurate, timely

information in order to bring buyers and sellers together.

(Compl. P160.)

Specialists are the bridges between buyers and sellers, shares and shareowners, issuers and investors, and they help to maintain the New York Stock Exchange's place among the world's most efficient and yet lucrative markets.

* * *

According to NYSE regulations, the specialist must always buy or sell against the current market trend, meaning the specialist can only buy when the stock is moving down and sell when it's moving up, which, once again, takes some of the volatility out of the market.

* * *

The specialist can't just throw his hands into the air and say, "I'm going to lose money if I make this trade—I'm going to just walk away." He is obliged to participate even when he knows the average investor wouldn't do so. His first responsibility is to the market and his second responsibility is to his own portfolio.

* * *

As reinforced by stringent NYSE regulations, the specialist may only step in to buy or sell when it is necessary to do so. That is, if there is a natural match between buyer and seller, the specialist stays out of the trade unless there is the opportunity to improve the price for either the buyer or the seller.

(Compl. P161.)

6. *Fleet Specialists And NYSE*

The Complaint alleges that the following allegedly false and misleading statements can be attributed to both Fleet Specialists and NYSE:

> On the New York Stock Exchange we put customers to customers 85 percent of the time, no dealer intervention. That's what creates frictionless trading on the New York Stock Exchange, no displacements, volatility profiles are lower than other markets, This is what we have been selling all these years, continues—it continues with innovation, it continues with technology wrapped around it, but the New York Stock Exchange is no different than any trading room on Wall Street . . . . the New York Stock Exchange, by not only being responsible for both sides of the transaction, the sell side and the buy side; not just adhering to one side of the transaction while discrediting the other side of the transaction. So this customer to customer, the constant flow is begetting liquidity, and that's why we do 84 percent of the volume listed trades . . . . I think it has been proven that when customers meet customers, a better price is achieved by the customer.
>
> * * *
>
> And by having time priority, the customer, again, is served best because he is shown that liquidity gets interacted with . . . . I am acting as a dealer and as an agent. I step aside when an order comes in at that price. I don't trade as a dealer at that price until the customer is satisfied . . . . there are other orders that interact other institutional orders at some time at the

> point of sale in the auction process. And there is time priority . . . . But the rules are the rules, that's why the NYSE has been so successful because of the standards and rules that our SRO and our market surveillance staff and enforcement division carry out. The exchange is not run by the members. The exchange is run by a board comprised of twelve industry people, twelve outside directors that represent industries, and we have three management directors on the board.

(Compl. PP180-81 (quoting Quick at November 12, 2002 SEC hearing)).

7. *Bear Wagner LLC*

Plaintiffs have alleged that the following statements by Bear Wagner LLC are false and misleading:

> Specialists manage the auction market in the specific securities allocated to them. They must maintain a fair, competitive, orderly and efficient market at all times, even in those market conditions considered extreme. This means that all customer orders have an equal opportunity to interact and receive the best price on execution. Bear Wagner Specialists prides itself on our ability to maintain exceptional markets in the stocks we trade in all market conditions, even in the most difficult and volatile periods of market activity.
>
> * * *
>
> The specialist acts as agent for all electronically-routed orders. A floor broker may also choose to leave an order with a specialist to

> represent it, in which case the specialist is acting as agent for the broker's order. As agent, the specialist assumes the same fiduciary responsibility as a broker.

(Compl. P157.)

> As trusted advisor and strategic partner to many of the world's most recognized brands, we bring vast experience and resources to companies joining the NYSE. Our advanced trading technology and financial strength ensure optimal levels of liquidity and capital support.
>
> Bear Wagner puts a team of 340 professionals to work on our clients' behalf. We are proud to be an extension of our 370 listed companies—accountable to them and committed to achieving market excellence.

(Bear Wagner LLC, *Bear Wagner Corporate Profile* (Updated September 2005), *at* http://www.bearwagner.com/are.html.)

8. *SIG Specialists*

The Complaint alleged that the following statements by SIG Specialists were false and misleading:

> The fundamental responsibility of a specialist on the New York Stock Exchange is to manage efficiently the trading of a company's shares, rapidly pairing off buyers and sellers while seeking the fairest possible execution for all parties involved. In the service of its listed companies, a specialist must also serve as a liquidity provider and a source of stability, at the same time offering information, insight and market commentary.

(Compl. P164.)

> SIG's substantial capital resources support SSI's ability to provide reliable liquidity, enhancing stability and continuity in the stock price. As a result, we can be more aggressive in accommodating customer and market risk than other specialist firms.

(SIG LLP, *Our Role as Specialist*, *at* http://www.sig.com/markets/specrole.html (last visited Sept. 14, 2005).)

9. *Performance Specialist*

The Complaint alleged that the following statements by Performance Specialist were false and misleading:

> Specialists must maintain a fair, competitive, orderly and efficient market. This means that all customer orders have an equal opportunity to interact and receive the best price. It also means that once auction trading begins, a customer should be able to buy or sell a reasonable amount of stock close to the last sale. Therefore, a specialist works to avoid large or unreasonable price variations between consecutive sales. The results: almost 98% of all trades take place at 1/8th point or less from the last sale.
>
> * * *
>
> A specialist is the agent for all SuperDot (electronically routed) orders. A floor broker may also choose to leave an order with a specialist to represent it until it can be executed at a specified price. This allows brokers to concentrate on other orders that require their immediate attention. As

an agent, a specialist assumes the same fiduciary responsibility as a broker.

* * *

In order to fulfill their role, specialists agree to several obligations. The first is to place and execute all customer orders ahead of their own . . . .

* * *

As principal, specialists supply the short-term liquidity for the market. Buying or selling against the trend, specialists help to reduce volatility and stabilize the market . . . .

* * *

As auctioneer, agent, catalyst and principal, specialists make a continuous market in a stock from the opening to the closing bell, insuring that shareholders have the opportunity to buy and sell stock as close to the last sale as possible.

(Compl. P163.)

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Master File No. 03-CV-8264(RWS)

In re NYSE SPECIALISTS SECURITIES LITIGATION

This Document Relates To: ALL ACTIONS

CLASS ACTION

~~[PROPOSED]~~ ORDER GRANTING LEAD PLAINTIFFS' REQUEST FOR CERTIFICATION OF FINAL JUDGMENT AND ENTRY OF JUDGMENT UNDER FEDERAL RULE OF CIVIL PROCEDURE 54(B)

Having considered Lead Plaintiffs' Request for Certification and Entry of Final Judgment Under Federal Rule of Civil Procedure 54(b), and good cause appearing therefor, the Court FINDS and ORDERS as follows:

There are multiple claims or parties to this litigation and plaintiffs' claims against the NYSE have all been finally determined.

As this Court's rulings on immunity and standing relate only to the plaintiffs' claims against the NYSE, and as an early appellate resolution of those issues may avoid an expensive and duplicative trial without delaying prosecution of the surviving claims, there is no just reason for delay.

The Request for Certification of Final Judgment is granted.

The Clerk is directed to enter Final Judgment as to the claims against the NYSE.

* * * *

ORDER

IT IS SO ORDERED.

DATED: 2-9-06

/s/ THE HONORABLE ROBERT W. SWEET
UNITED STATES DISTRICT JUDGE

Submitted by:

LERACH COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
WILLIAM S. LERACH
MARK SOLOMON
BYRON S. GEORGIOU
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/s/

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APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

03-CV-8264(RWS)

In re NYSE SPECIALISTS SECURITIES LITIGATION

This Document Relates To: ALL ACTIONS.

RULE 54(B) JUDGMENT

The lead plaintiffs having moved for certification and entry of final judgment under Fed. R. Civ. P. 54(b), and the matter having come before the Honorable Robert W. Sweet, United States District Judge, and the Court, on February 9, 2006, having rendered its Order finding as follows:

There are multiple claims or parties to this litigation and plaintiffs' claims against the NYSE have all been finally determined;

As this Court's rulings on immunity and standing relate only to the plaintiffs' claims against the NYSE, and as an early appellate resolution of those issues may avoid an expensive and duplicative trial without delaying prosecution of the surviving claims, there is no just reason for delay;

Granting the Request for Certification of Final Judgment; and Directing the Clerk of the court to enter Final Judgment as to the claims against the NYSE, it is

ORDERED, ADJUDGED AND DECREED: That for the reasons stated in the Court's Order dated February 9, 2006, pursuant to Fed. R. Civ. 54(b):

There are multiple claims or parties to this litigation and plaintiffs' claims against the NYSE have all been finally determined;

As this Court's rulings on immunity and standing relate only to the plaintiffs' claims against the NYSE, and as an early appellate resolution of those issues may avoid an expensive and duplicative trial without delaying prosecution of the surviving claims, there is no just reason for delay;

The Request for Certification of Final Judgment is granted; and

Final Judgment is entered as to the claims against the NYSE.

Dated: New York, New York

February 17, 2006

J. MICHAEL McMAHON
Clerk of Court

By: /s/
Deputy Clerk

APPENDIX E

SECURITIES AND EXCHANGE COMMISSION
PRESS RELEASE
(APRIL 12, 2005):

SEC CHARGES THE NEW YORK STOCK EXCHANGE WITH FAILING TO POLICE SPECIALISTS

NYSE Agrees to Settlement With SEC, Including Censure, Cease and Desist Order, $20 Million Fund for Regulatory Auditor, and Audio-Video Surveillance

FOR IMMEDIATE RELEASE 2005-53

Washington, D.C., April 12, 2005—The Securities and Exchange Commission today instituted and simultaneously settled an enforcement action against the New York Stock Exchange, Inc., finding that the NYSE, over the course of nearly four years, failed to police specialists, who engaged in widespread and unlawful proprietary trading on the floor of the NYSE. The Commission found that the NYSE violated Section 19(g) of the Securities Exchange Act of 1934 by failing to enforce compliance with the federal securities laws and NYSE rules which prohibit specialists from "interpositioning" and "trading ahead" of customer orders.

In settling this action, the NYSE consented, without admitting or denying the findings, to entry of an order imposing a censure and requiring the NYSE to cease and desist from future violations of the federal securities laws. The NYSE also agreed to several significant remedial measures designed to strengthen the NYSE's oversight of specialists and other floor members. The NYSE agreed to an undertaking of $20 million to fund regulatory audits of the NYSE's

regulatory program every two years through the year 2011. The NYSE has also agreed to implement a pilot program for video and audio surveillance on its trading floor for at least an eighteen-month period.

Stephen M. Cutler, Director of the Commission's Division of Enforcement, said, "Self-Regulatory Organizations like the New York Stock Exchange have been a critical part of the regulatory landscape for almost a century now. When SROs don't vigorously police and prosecute wrongdoing in their markets, investors suffer. As our investigation continues, we will be focusing on individuals who may have fallen down on the job and contributed to the failure that resulted in the case we bring today."

Mark K. Schonfeld, Director of the Commission's Northeast Regional Office, added, "This settlement is about protecting investors. The relief we have obtained in this action will raise the bar for regulation at the NYSE and help prevent misconduct on the NYSE floor from going undetected again. The video and audio surveillance will help the NYSE keep a watchful eye on the specialists, and the regulatory auditor will keep a watchful eye on the NYSE's performance as a regulator."

Specifically, the Commission's Order finds that from 1999 through 2003, various NYSE specialists repeatedly engaged in unlawful proprietary trading, resulting in more than $158 million of customer harm. The improper trading took various forms, including "interpositioning" the firms' dealer accounts between customer orders and "trading ahead" for their dealer accounts in front of executable agency orders on the same side of the market. From 1999 through almost all of 2002, the NYSE failed to adequately monitor and police specialist trading activity,

allowing the vast majority of this unlawful conduct to continue. The illegal trading went largely undetected because the NYSE's regulatory program was deficient in surveilling, investigating and disciplining the specialists' trading violations.

Specifically, the NYSE failed in 3 primary areas.

The NYSE Failed to Adequately Surveil for Trading Ahead and Interpositioning Violations: The NYSE established and relied on an overbroad surveillance system for trading ahead, which captured only a small fraction of violations. Despite advice by the NYSE's internal audit group and other indications that the surveillance was inadequate to detect the full extent of trading ahead, the NYSE failed to make necessary adjustments to the surveillance parameters.

The NYSE Failed to Adequately Investigate Trading Ahead and Interpositioning Violations: Although the NYSE's existing surveillance parameters were designed to capture only the most egregious instances of trading ahead and interpositioning, the surveillance unit responsible for reviewing the alerts routinely ignored scores of likely violations. When the surveillance unit made referrals to the NYSE's investigative unit, investigators failed to investigate the full extent of the misconduct.

The NYSE Failed to Appropriately Discipline Trading Ahead and Interpositioning Violations: Despite compelling evidence of misconduct, the NYSE routinely failed to take disciplinary action or imposed only the most minor of sanctions.

The Commission's Order finds that the NYSE violated Section 19(g) of the Exchange Act by failing to enforce compliance with the federal securities laws

and NYSE rules that prohibit unlawful proprietary trading by specialists—specifically, Section 11(b) of the Exchange Act, Rule 11b-1 thereunder, and NYSE Rules 92 and 104.10. Without admitting or denying the Commission's findings, the NYSE has agreed to a censure, an order to cease and desist from further violations of Section 19(g) of the Exchange Act, and to implement certain remedial undertakings, including:

Retention of a Regulatory Auditor: The NYSE will set aside a $20 million reserve fund to retain a regulatory auditor to conduct audits of the NYSE's regulatory program every 2 years through 2011. The regulatory auditor will assess whether the NYSE's regulatory policies and procedures are reasonably designed and effective to detect and deter securities laws violations and whether the NYSE's regulatory group is in compliance with its policies and procedures.

Implementation of a Pilot Audio and Video Surveillance System: The pilot program will be conducted over an eighteen month period and involve at least 20 NYSE stocks. Following an independent evaluation of the pilot program, the Commission will determine whether to modify, eliminate, or expand the program to the entire NYSE trading floor.

Other significant undertakings include: (i) systems and procedures to track the identity of specialists and clerks trading on the NYSE floor; (ii) enhancements to the NYSE's electronic trading systems to prevent specialists from engaging in trading ahead and interpositioning; (iii) enhancements to the NYSE's referral process and the training of its regulatory staff; and (iv) certification by the NYSE's Chief Regulatory Officer every year for a period of 5 years that the NYSE is in compliance with the Commission's Order.

This failure by the NYSE to police trading ahead and interpositioning by specialists follows on the heels of a regulatory failure by the NYSE in the late 1990s involving independent floor brokers, which was addressed by the Commission in an order against the NYSE in June 1999. See In the Matter of New York Stock Exchange, Inc., Release No. 34-41574 (June 29, 1999).

The Commission has previously brought settled enforcement actions against all seven specialist firms responsible for the unlawful proprietary trading at issue in this case. See In the Matter of Bear Wagner Specialists LLC, Rel. No. 34-49498 (March 30, 2004); In the Matter of Fleet Specialist, Inc., Rel. No. 34-49499 (March 30, 2004); In the Matter of LaBranche & Co. LLC, Rel. No. 34-49500 (March 30, 2004); In the Matter of Spear, Leeds & Kellogg Specialists LLC, Rel. No. 34-49501 (March 30, 2004); In the Matter of Van der Moolen Specialists USA, LLC, Rel. No. 34-49502 (March 30, 2004); In the Matter of SIG Specialists, Inc., Rel. No. 34-50076 (July 26, 2004); In the Matter of Performance Specialist Group LLC, Rel. No. 34-50075 (July 26, 2004).

The Commission's investigation of individual misconduct as it relates to the NYSE's failures to police specialists is continuing.

APPENDIX F

NEW YORK STOCK EXCHANGE STATEMENT REGARDING THE SEC'S CENSURE (APRIL 12, 2005)

The New York Stock Exchange (NYSE) today issued the following statement in response to the U.S. Securities and Exchange Commission's (SEC) censure of the NYSE for failing to properly detect, investigate and discipline improper Floor trading practices from 1999 to 2002.

Richard G. Ketchum, chief regulatory officer of the NYSE since March 8, 2004, said, "Major strides have been taken to enhance the Exchange's regulatory program and investor protection. Staff and technology resources have been increased. New heads of the Market Surveillance, Member Firm Regulation and Enforcement divisions were appointed. A new department within Market Surveillance was created to analyze surveillances and propose new or modified surveillances. New regulatory technology has been installed to establish better controls and accountability on the Floor. In particular, the 'DOT Priority' application prevents specialists from trading ahead of customers unless they provide an explanation that is reviewed by NYSE Regulation. To further protect investors, we have proposed to the SEC that when a specialist has completed a trade with the crowd for his own account but not yet reported it and an incoming customer order appears, the specialist must yield to the customer order. And in creating the Hybrid MarketSM, NYSE Regulation is working hand-in-hand with the NYSE technology team to assure that they program in regulatory quality controls right along with trading functionality.

Our new governance structure, approved by the SEC on December 17, 2003, provides numerous safeguards to ensure that NYSE Regulation is insulated from influence of Exchange members, member firms, and listed companies. We are independent from the business-side in our decision-making. This new structure is working.

"The New York Stock Exchange accepts and acknowledges the SEC's criticisms. Our board and entire organization are committed to take whatever additional steps are necessary, including carrying out the undertakings contained in the settlement agreement, to meet our surveillance and enforcement obligations. Specialist firms have changed, as have we."

Marshall N. Carter, chairman of the NYSE board of directors and past chairman of the board's Regulatory Oversight Committee, said, "The Board of Directors is committed to provide the guidance and resources necessary to ensure that NYSE Regulation carries out its program with the highest standards of ethics and integrity. A vigorous and independent regulatory program is essential to the New York Stock Exchange. We are pleased with the progress that has been made so far and we will continue to enhance investor protection."

Stated Ketchum: "NYSE Regulation plays a critical role in monitoring and regulating the activities of its members, member firms and listed companies by enforcing compliance with NYSE rules and federal securities laws. We are passionate about protecting investors and ensuring the integrity of the NYSE. We pledge to continue working until we have completed every issue in the SEC Order."

About NYSE Regulation

On December 17, 2003, the SEC approved a new governance structure for the NYSE. Under the new design, the NYSE Board of Directors is comprised solely of independent directors, except for the chief executive officer, who have no affiliation with any regulated member firm. A new position of chief regulatory officer was created and reports directly to the board of directors through a new Regulatory Oversight Committee consisting of independent directors. As a result, NYSE Regulation is insulated from potential influence from NYSE members, member firms, as well as listed companies and operates separately from the business side and is independent in its decision-making.

NYSE Regulation plays a critical role in monitoring and regulating the activities of its members, member firms and listed companies, as well as enforcing compliance with NYSE rules and federal securities laws. Nearly 400 of the largest securities firms in America are members of the New York Stock Exchange. These firms service 92 million customer accounts, or 90 percent of the total public customer accounts handled by broker-dealers, with total assets of over $3 trillion. They operate from 19,000 branch offices around the world and employ 146,000 registered personnel. Nearly 700 employees, or more than 40 percent of the Exchange's staff, work for NYSE Regulation, which consists of four divisions: Market Surveillance, Member Firm Regulation and Enforcement and Listed Company Compliance.

APPENDIX G

STATUTES

Securities Exchange Act §3(a)(26), 15 U.S.C. §78c(a)(26):

(26) The term "self-regulatory organization" means any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of sections 19(b), 19(c), and 23(b) of this title) the Municipal Securities Rulemaking Board established by section 15B of this title.

* * * *

Securities Exchange Act §6(a)-(b), 15 U.S.C. §78f(a)-(b):

(a) Registration; application

An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section and in accordance with the provisions of section 78s(a) of this title, by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) Determination by Commission requisite to registration of applicant as a national securities exchange

An exchange shall not be registered as a national securities exchange unless the Commission determines that—

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this chapter and to comply, and (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange.

(2) Subject to the provisions of subsection (c) of this section, the rules of the exchange provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof.

(3) The rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer.

(4) The rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

(5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to

protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.

(6) The rules of the exchange provide that (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of this chapter, the rules or regulations thereunder, or the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

(7) The rules of the exchange are in accordance with the provisions of subsection (d) of this section, and in general, provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof.

(8) The rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

(9) The rules of the exchange prohibit the listing of any security issued in a limited partnership rollup transaction (as such term is defined in paragraphs (4) and (5) of section 78n(h) of this title), unless such

transaction was conducted in accordance with procedures designed to protect the rights of limited partners, including—

(A) the right of dissenting limited partners to one of the following:

(i) an appraisal and compensation;

(ii) retention of a security under substantially the same terms and conditions as the original issue;

(iii) approval of the limited partnership rollup transaction by not less than 75 percent of the outstanding securities of each of the participating limited partnerships;

(iv) the use of a committee of limited partners that is independent, as determined in accordance with rules prescribed by the exchange, of the general partner or sponsor, that has been approved by a majority of the outstanding units of each of the participating limited partnerships, and that has such authority as is necessary to protect the interest of limited partners, including the authority to hire independent advisors, to negotiate with the general partner or sponsor on behalf of the limited partners, and to make a recommendation to the limited partners with respect to the proposed transaction; or

(v) other comparable rights that are prescribed by rule by the exchange and that are designed to protect dissenting limited partners;

(B) the right not to have their voting power unfairly reduced or abridged;

(C) the right not to bear an unfair portion of the costs of a proposed limited partnership rollup transaction that is rejected; and

(D) restrictions on the conversion of contingent interests or fees into non-contingent interests or fees and restrictions on the receipt of a non-contingent equity interest in exchange for fees for services which have not yet been provided.

As used in this paragraph, the term "dissenting limited partner" means a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by the exchange, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under the rules of the exchange during the period during which the offer is outstanding.

* * * *

Securities Exchange Act §10, 15 U.S.C. §78j:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

(a)(1) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(2) Paragraph (1) of this subsection shall not apply to security futures products.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national

securities exchange or any security no so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or record-keeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under section 17(a) of the Securities Act of 1933 and sections 9, 15, 16, 20, and 21A of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

* * * *

Securities Exchange Act §19(g), 15 U.S.C. § 78s(g):

§ 78s. Registration, responsibilities, and oversight of self-regulatory organizations

* * * *

(g) Compliance with rules and regulations

(1) Every self-regulatory organization shall comply with the provisions of this chapter, the rules and regulations thereunder, and its own rules, and (subject to the provisions of section 78q(d) of this title, paragraph (2) of this subsection, and the rules thereunder) absent reasonable justification or excuse enforce compliance—

(A) in the case of a national securities exchange, with such provisions by its members and persons associated with its members;

(B) in the case of a registered securities association, with such provisions and the provisions of the rules of the Municipal Securities Rulemaking Board by its members and persons associated with its members; and

(C) in the case of a registered clearing agency, with its own rules by its participants.

(2) The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this chapter, may relieve any self-regulatory organization of any responsibility under this chapter to enforce compliance with any specified provision of this chapter or the rules or regulations thereunder by any member of such organization or person associated with such a member, or any class of such members or persons associated with a member.

* * * *

APPENDIX H

SECURITIES AND EXCHANGE COMMISSION RULE 10b-5, 17 C.F.R. 240.10b-5:

Sec. 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.